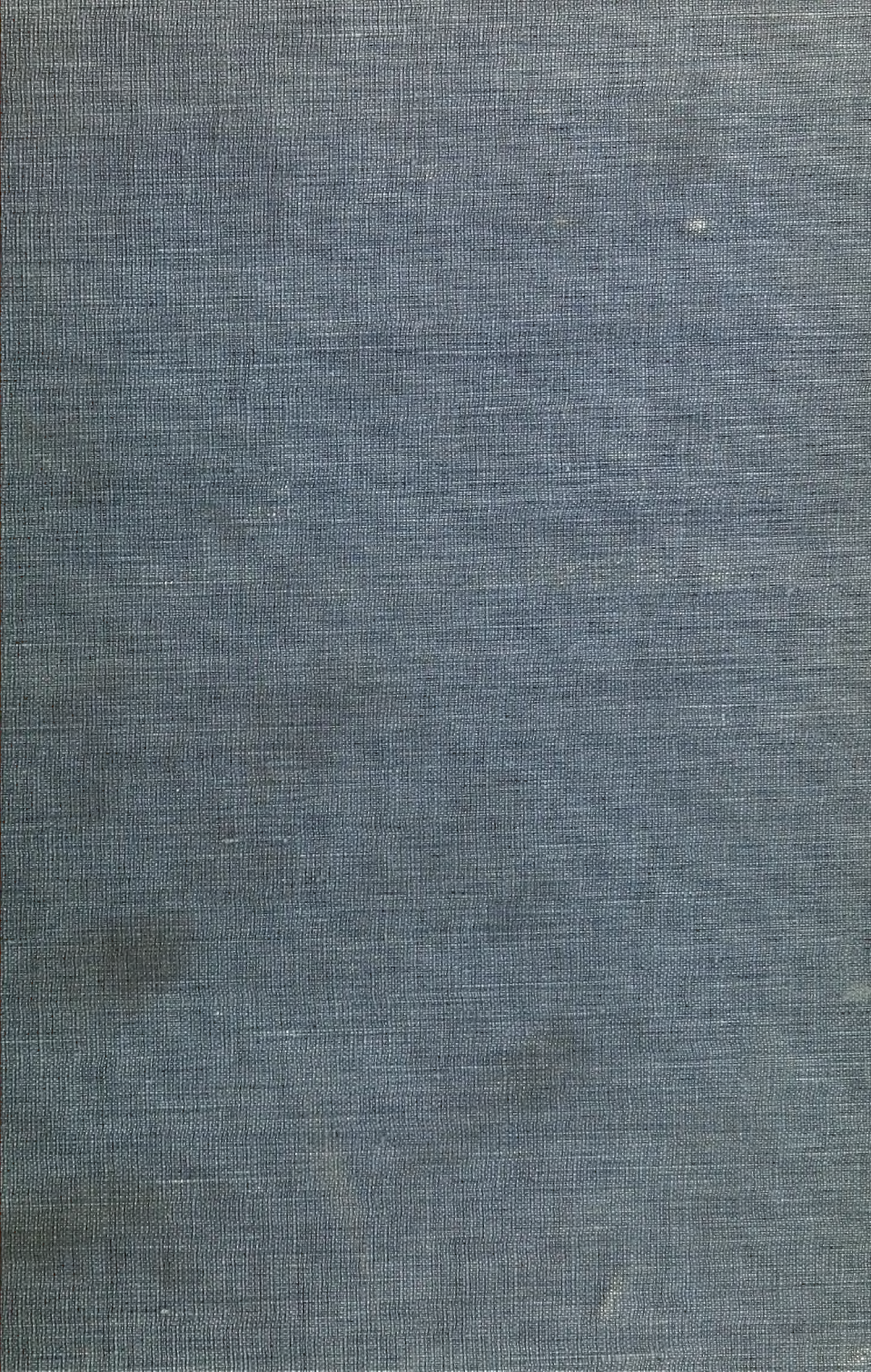
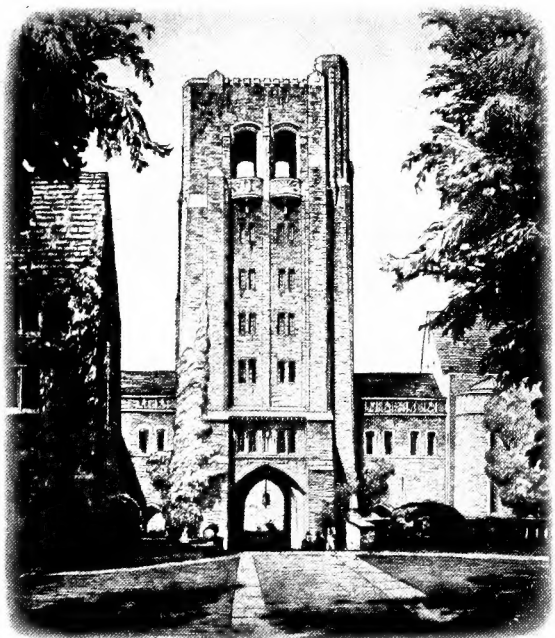






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NEW YORK STATE INCOME TAX PROCEDURE 1921

Including Corporation
Franchise Tax

By

ROBERT H. MONTGOMERY, C.P.A.

of Lybrand, Ross Brothers and Montgomery; Attorney-at-Law; Former President, American Association of Public Accountants; Professor of Accounting, Columbia University.



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PREFACE

In the 1920 edition of *Income Tax Procedure* I discussed the differences between federal and New York State procedure. My publishers tell me that those who do not live in New York objected to the space given to so unimportant a subject, and many who live in New York objected to the incomplete and inadequate presentation of a subject of such great importance.

Naturally it would be foolish to repeat something which pleased no one, and as there has been a gratifying demand for a book dealing solely with New York procedure, I have endeavored to comply with the demand. If federal income tax procedure were not complicated it would be an easy task to administer a state law which in most respects duplicates the federal law, but at its best an income tax law presents many close problems, and there are in addition many differences between the rights and inhibitions of the federal and state constitutions.

These differences are summarized in Chapter II and are discussed in detail in the appropriate chapters.

No apology, but perhaps an explanation, is needed for the frequent references in this book to 1921 federal *Income Tax Procedure*. I have tried to discuss fully and explain all of the major points involved in the preparation of the New York State returns, but there are hundreds of special points which seldom arise and which could not be discussed in this book unless some hundreds of pages were added. I have therefore assumed that those wishing to be fully informed regarding special points will find the references to 1921 federal *Income Tax Procedure* helpful.

Taxpayers subject to the federal law have suffered much. Part of the suffering has been necessary and part of it has been unnecessary. It is proposed to consolidate the adminis-

tration and collection of all New York State taxes into one office. If this is done it is to be hoped that the new office or bureau will administer the personal income and franchise tax laws as efficiently and courageously as the income tax law has been administered under the Director of the Income Tax Bureau of the Comptroller's office. Taxpayers have received the attention to which they are entitled under the administration of the Comptroller's staff, inquiries have been promptly answered, hearings granted and decisions made with due regard to the interests of the state and the taxpayer. An income tax law will not survive unless it is administered with some such regard for the convenience and rights of taxpayers.

Separate indexes have been prepared for each part of the volume so as to facilitate reference to either the personal income tax law or to the franchise tax law. In addition, indexes to sections of each law and to the Comptroller's regulations have been included as well as comparative indexes of Regulations 45 and the Comptroller's regulations.

In the preparation of this volume I have had the invaluable assistance of my partner, Walter A. Staub, C. P. A., my colleague at Columbia University, Professor Robert Murray Haig, and my assistants J. Marvin Haynes of the Bar of the District of Columbia, Robert Buchanan and Hamilton Howard. I also desire to express my appreciation of the authoritative material contained in the New York Income Tax Service of the Corporation Trust Company, New York, which I have used very freely with the company's kind permission.

ROBERT H. MONTGOMERY.

55 Liberty St., New York,
March 10, 1921.

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NEW YORK STATE
INCOME TAX PROCEDURE
1921
(Including Corporation Franchise Tax)

CHAPTER I

INTRODUCTORY

General

The taxation of incomes, now the chief reliance of our federal financial system, is rapidly becoming established as an important source of state revenue as well. Even the high rates imposed by the federal government during the past four years have not exhausted the field, and several of the states have adopted this form of taxation. In fact the existence of the federal tax, because of the ease with which state taxes could copy the federal law and procedure, has probably encouraged their establishment. Driven by the necessity of raising larger and larger sums for state purposes, blocked from increasing levies on property by the crushing burdens already imposed on real estate and by the administrative impossibility of reaching other types of property equitably and successfully, one state after another has eagerly turned to the income tax as the solution of its fiscal difficulties.

In New York the complexity of the economic situation and the difficult problem of the commuting non-resident constituted obstacles which gave rise to serious misgivings. However, after Wisconsin had completed a record of eight years of administrative success and after Massachusetts had demonstrated her ability to administer the tax in a highly developed industrial community, New York threw caution to the winds and adopted a general state income tax. This was in 1919. Two years before this New York had transformed her franchise tax on corporations into a tax on net incomes.

The experience of New York during the one year in which the general income tax law has been in effect appears on the whole to be reassuring. The law has been intelligently administered. It has produced more than thirty-seven millions of

revenue.¹ It has resulted in a distinct improvement in the distribution of the tax burden. Apparently a new permanent element has been added to the state tax system which will tend to increase rather than to diminish in importance as time goes on.

The problems of procedure under this new income tax law are so numerous and important as to necessitate their treatment in this separate volume.

The Development of Income Taxation in the States

As a background for the study of the problems of procedure under the New York income tax laws it is of interest to consider briefly the development of such taxes in other states.

Early laws.—Certain “faculty” taxes, which bore some slight resemblance to income taxes, were established by the Colonies before the formation of the Union, but, although some of these persisted into the nineteenth century, the modern income tax is not their lineal descendant.² Rough prototypes of the income tax also appeared in the forties during the period of internal improvement projects; but these amounted to little more than an elaborate system of licenses.³ The financial stress of the Civil War stimulated a temporary development of income taxes in the southern states. With the possible exception of the Virginia tax, however, these efforts were of negligible importance.⁴ Unimportant, also, were the state income taxes which developed in the nineties. The history of income taxation in the states before the year 1910 is a record of dismal failure. At that time, although a large number of states had experimented, with it, all had abandoned it save

¹In a statement issued February 17, 1921, the precise amount was reported as \$37,354,865. *New York Times*, February 18, 1921.

²Seligman, *The Income Tax*, page 367 *et seq.* See also Delos O. Kinsman, *The Income Tax in the Commonwealths of the United States* (New York, 1903).

³Seligman, *The Income Tax*, page 399 *et seq.*

⁴*Ibid.*, page 406 *et seq.*

five.⁵ The administration had been poor, the yields had been light and the tax had been unpopular. In agricultural states the incomes of farmers were the chief difficulty, while in industrial states the presence of state boundaries formed a serious obstacle. As a consequence, expert opinion was almost unanimous in the verdict that the income tax could succeed only as a federal tax. It remained for Wisconsin to upset this conclusion and to provide an impetus toward a new development of state income taxation.

The Wisconsin income tax law.—Wisconsin for many years attempted to enforce a general property tax and as usual found the taxation of personal property a baffling problem. The dissatisfaction of the people with this tax was cleverly used to induce a favorable reception for the state income tax which was introduced in 1911.⁶ Instead of being presented as an entirely new tax in addition to all existing taxes, the income tax appeared virtually as a substitute for the unpopular personal property tax. It was provided that certain types of personal property should be entirely exempt from taxation and that any taxes paid on the remaining personal property might be subtracted by the taxpayer from his income tax. This skilful combination with the existing system was largely instrumental in winning for the new tax the hearty co-operation of the taxpayers upon which an income tax is so dependent. The system was an immediate and striking success.⁷ The state taxation of incomes was shown to be feasible.

In addition to favorable environment two other factors contributed largely to the success of the Wisconsin law: the soundness and simplicity of the statute itself, and the quality of its administration. Recognizing the futility of depending

⁵Virginia, North Carolina, South Carolina, Massachusetts and Oklahoma, *ibid.*, page 414.

⁶Laws of 1911, chapter 658.

⁷For a detailed account of the operation of the Wisconsin law, see T. S. Adams, "The Wisconsin Income Tax," *American Economic Review*, December, 1911; "The Significance of the Wisconsin Income Tax," *Political Science Quarterly*, December, 1913.

upon locally elected officers—the method tried by other states and found unsatisfactory—the assessment of the income tax was vested in the State Tax Commission, whose district assessors were to be appointed after civil service examinations. This resulted in the development of a permanent and expert force entirely removed from local pressure.

The law overcomes several difficult problems in an ingenious manner. Income from interstate sources is apportioned by rules which, while arbitrary, are approximately just. The difficulty in regard to farmers' incomes is overcome in part by the tax on personal property which, operating as a kind of minimum income tax, prevents much evasion. Personal exemptions are moderate—an individual is permitted \$800; husband and wife are allowed \$1,200; for each child under 18 and each other dependent, \$200 additional may be deducted. The rates are low and slightly progressive, varying from 2 to 6 per cent in the case of corporations, and from 1 to 6 per cent in the case of individuals. The yield is divided between the state and its political subdivisions: 70 per cent goes to the locality, 20 per cent to the county and 10 per cent to the state. Holding companies are not penalized by double taxation of dividends. Taxes are deductible from income only when paid upon property from which income is derived.⁸ These statements are sufficient to indicate the general nature of this law and to point out some of the particulars in which it is superior to state income taxes which have been less successful.

The Massachusetts law.—Massachusetts has followed the lead of Wisconsin in attempting to solve the problem of state taxation by adopting an income tax on new lines. Here also the income tax is grafted upon the old property tax in substitution for degenerated taxes upon personal property, but the process differs somewhat from that in Wisconsin. The

⁸Formerly the estimated rental of residence property occupied by the owner was taxable as income. This was changed in 1917. *The Wisconsin Income Tax, With Explanatory Notes* (3rd edition, Madison, 1917).

law which was adopted in 1916⁹ does not attempt to reach all income, but merely that which accrues from three sources: (1) intangible personal property; (2) annuities, trades and professions; and (3) speculative dealings in intangible personal property. There is an interesting difference in the rates applied to these incomes. Income from intangible property is taxed 6 per cent; income from annuities, trades and professions is taxed 1½ per cent; and the excess of gains over losses resulting from purchases and sales of intangible personal property is taxed 3 per cent. Here as in Wisconsin a centralized administrative system is provided, the assessors being appointed by the State Tax Commissioner. The reported results of the first year of operation indicate that the law is highly successful.

Income tax in other states.—Other states have followed the example of Wisconsin and Massachusetts in adopting income as a base for taxation. Thus Missouri in 1917 imposed a tax which closely followed the federal statute.¹⁰ As early as 1915 Connecticut began to tax corporations on the basis of net income, adopting the federal law as its own so far as the determination of income is concerned.¹¹ Like Connecticut, West Virginia has an income tax, established in 1915, applying only to corporations.¹² Delaware, Oklahoma, Montana and North Dakota have also established income taxes.¹³

⁹Charles J. Bullock, *The Massachusetts Income Tax* (Boston, 1916). The Massachusetts law was slightly amended in 1920. Laws, ch. 257, 352.

¹⁰*Bulletin of the National Tax Association*, May, 1917, pages 222-223. The law was radically amended by an act passed May 6, 1919.

¹¹*Bulletin of the National Tax Association*, February, 1916, page 8.

¹²In 1917. Acts of the legislature of West Virginia, Second Extraordinary Session, 1915, chapter 3, sections 5-16; Second Extraordinary Session, 1917, chapter 6, sections 3-5. The West Virginia laws of 1915 provided that duplicates of federal returns under the 1913 federal law were acceptable. No change has been made to permit the use of duplicates under the 1916 and 1917 federal laws, with the result that separate state returns are required.

¹³*Proceedings of the National Tax Association*, 1918, page 386. The Delaware law which was established in 1917 will be found in the session laws, chapter 26. The Oklahoma law was passed in 1915 (session laws,

It will be observed that the state income tax laws either provide for highly centralized expert administration by state authorities or lean very heavily upon the federal income tax administration.

The Development of the New York Law

The adoption of the income tax in New York was the culmination of a development which had been under way for many years.¹⁴ Indeed, shortly after the Civil War the breakdown of the general property tax was foreseen, and since that time the various modifications of the tax system have all tended steadily toward a real estate tax supplemented by an income tax on both businesses and individuals. The first phase of this movement consisted of an attempt to segregate the sources of state and local revenue, with the intention of reforming the real estate tax and delegating its application to localities and of replenishing the state treasury by a series of special taxes. By 1910 this first phase had been completed. The situation at this point is admirably described by Professor Seligman.¹⁵

Toward the beginning of the second decade of the present century a new situation developed. An unlooked-for tendency in the direction of vastly increased outlays on the part of both state and locality now appeared; the final fruits of a democracy which was determined to utilize government to achieve definite social ends disclosed itself. In the state government the expenditures went up by leaps and bounds, not only because of the assumption by government of such functions as the care of the hospitals and the administrative super-

page 282). The Montana law, a 1917 statute, is found in chapter 79 of the session laws.

For a description of the North Dakota statute, see H. L. Laty, "Progress of State Income Taxation," *American Economic Review*, March, 1920. New Mexico passed an income tax law in 1919 (1919 session laws, chapter 123), but the Supreme Court of the state recently declared the statute unconstitutional. No effort had been made to enforce it. An Alabama law passed in 1919 has been declared unconstitutional (*Bulletin of the National Tax Association*, April, 1920).

¹⁴For a full treatment of the course of tax reforms in New York during recent decades, see Professor Edwin R. A. Seligman's article entitled "The New York State Income Tax" which appeared in the *Political Science Quarterly* for December, 1919.

¹⁵*Political Science Quarterly*, December, 1919, pages 524-526.

vision of many forms of industry and transportation but more especially because of the program of improved roads and of an enlarged Erie Canal. The result was that the augmented current expenses together with the provision for the rapid amortization of the large debt before long took up the entire slack of the so-called indirect taxes and rendered necessary in 1912 the reimposition of state direct tax, first in a hesitant and then in a more determined way. It was thus made clear that the system of separation of source, which had done good service in the interval, could not be regarded as a final solution of the problem and that while it had indeed served to postpone the crisis and undeniably possessed certain elements of lasting worth, the next stage of reform must be sought elsewhere.

In the meantime the local situation had become aggravated. Just as New York state in its fiscal reforms and in its adoption of the principle of separation of source paved the way for many other commonwealths, so what was happening in New York City repeated itself before long in the other industrial centers of the state. In New York, as elsewhere, personal property had almost entirely disappeared from the assessment lists, so that the local tax had become virtually a tax on real estate. As the local expenses increased by leaps and bounds and as the base of taxation was gradually narrowed instead of broadened, the tax rate began to climb to alarming figures. The real-estate interests now clamored for relief; and the public at large, which realized that the tax on buildings at least was shifted to them in the shape of increased rent, seconded the efforts of the real-estate owners. Two projects of reform were now advanced. One was the plan of the single-taxers, based upon a misapprehension of what was actually happening in Canada, which demanded the exemption of buildings from taxation. This aroused so much interest that it led to the appointment, in 1915, of the mayor's tax committee, which studied the problem for two years and finally disapproved the plan for the reason that it would still further increase the inequality of taxation. The other proposal was the classification of taxation in the sense of imposing different tax rates upon different kinds of property. This principle had, indeed, been followed in part from the very beginning, as we have seen, in that certain forms of property invested in corporations or securities had been taxed for state purposes at special rates. But the specific proposition now advanced, that virtually all forms of tangible and intangible personalty should be taxed for local purposes also at varying even though somewhat lower rates, proved to be inadmissible in a state like New York, where for many decades the taxation of merchants on stock in trade or of the various forms of intangible personalty had long since practically disappeared. Whatever may have been true in other less developed industrial states, the classified property tax was evidently not the desirable reform for New York.

Thus both separation of source and classification of taxation, much vaunted as they were for the time being, showed themselves unsuitable. It was necessary to resort to something else. This something else proved to be the income tax.

When, with the outbreak of the war, an acute need developed for additional funds for the city of New York, the Mayor's Committee on Taxation recommended an income tax, and almost simultaneously Senator Mill's Joint Legislative Committee on Taxation made the same suggestion.¹⁶ The immediate result was the adoption of the income basis for the state taxation of corporations under the Emerson law of 1917. Two years later the final step was taken when the personal income tax law was established.

The Emerson Act of 1917.—The law of 1917 established what was virtually an income tax on corporations. It is variously designated as the "Emerson Act" or the "Franchise Tax Law." Its original provisions specifically excluded public utilities, holding companies, banks and insurance companies, so that the act applied merely to manufacturing and mercantile corporations. The rate was originally fixed at 3 per cent but was increased to $4\frac{1}{2}$ per cent in 1919. The base upon which the tax is levied is net income as determined for federal tax purposes, with several important adjustments. The latter include the disallowance of deductions of federal income and profits taxes, of any losses of years other than the taxable year which may have been subtracted in the federal returns under one of the special relief provisions of the federal law, dividends and Liberty bond interest. The difficult case of the corporation which does not transact its business entirely in New York is met by a provision (section 214) which allocates the income by a highly complicated and artificial method. The taxable income in such cases is determined by applying a percentage in the establishment of which the corporation's property, accounts receivable and stock ownership within the state are the factors

¹⁶*Political Science Quarterly*, December, 1919, page 528.

of importance. One-third of the amount collected is distributed to local communities and two-thirds go to the state treasury.

It should be borne in mind that this Emerson Act is a business tax, specifically designed to replace certain other taxes which formerly applied to corporations. It is not to be considered as an integral part of a general state income tax. Legally and economically it is a thing apart. The following language of the statute is pertinent:

LAW. Section 209. For the privilege of exercising its franchise in this state in a corporate or organized capacity every domestic corporation, and for the privilege of doing business in this state, every foreign corporation . . . shall . . . pay . . . an annual franchise tax.

The income tax law of 1919.—In 1919 the legislature at last established a personal income tax¹⁷ which applied to persons, estates and trusts, both resident and non-resident. Important amendments were added in 1920. The rates were low and slightly progressive, ranging from 1 to 3 per cent.

In defining "income" the law merely paraphrased the federal statute, with such changes as seemed necessary to fit the case. Some of these—such, for example, as the selection of January 1, 1919, in place of the federal date of March 1, 1913—will diminish in importance with the passage of time. Other departures from the federal definition of income are the inclusion of state¹⁸ salaries and interest on state securities generally, the exclusion of federal salaries and interest on federal securities and the refusal to permit the deduction of income or profits taxes.

The application of the law to non-residents and to estates and trusts was closely analogous to the federal practice.

The nature of the New York income tax can be most clearly grasped when it is recalled that it is intended to be a combination of business income tax and personal income tax.

¹⁷Laws 1919, chapter 627.

¹⁸Including political subdivision.

At the time of its adoption two separate taxes were seriously considered, one applying to all income received by residents, and a second applying to all business income arising within the state. An arrangement which would apply to income accruing to residents only would not have been well adapted to the situation in New York where many men doing business in the state commute to Connecticut and New Jersey. The state already had a tax in force applying to corporations. The final solution took the form of the establishment of the so-called personal income taxation of residents on all income from business and all dividends, and of non-residents on all income from property owned and from every business, trade, profession or occupation carried on within the state. Certain of the provisions of the law cannot be explained except on the ground of this dual character of the tax.

The yield of the state income tax is divided evenly between the state treasury and the local communities, provision first being made for an accumulation for refunds. The apportionment among the counties is made in proportion to the local real estate assessments. This is operating as a powerful force in raising the level of such assessments.¹⁹

1920 amendments.—Numerous amendments were found necessary in 1920, several because of court decisions and several because of defects discovered in the course of a year's administrative experience.

The Supreme Court of the United States on March 1, 1920, decided, in the case of *Travis v. Yale and Towne Manufacturing Company*,²⁰ that the failure to allow non-residents the same personal exemptions which were allowed to residents was in violation of the federal Constitution. The legislature consequently proceeded to grant the full personal exemptions to non-residents and to reimpose the tax for 1919. The same decision nullified the provision for withholding the tax from

¹⁹*New York Times*, June 4, 1920.

²⁰Decision quoted in full in Appendix B.

the salaries of non-residents, and this made necessary certain changes in the sections prescribing the conditions under which the tax should be withheld at the source.

The restriction upon the deduction of interest paid on money borrowed and the provision limiting contributions to New York corporations in so far as they applied to residents were swept away.

The time of filing returns was fixed at a point one month later than the federal returns and fiscal year returns were made to fall due three and one-half months after the end of the accounting period instead of on the federal due date, which is two and one-half months after the end of the accounting period.

Unproductive intangible personal property was made exempt from property taxes. During 1919 such property had been subject to the local property tax rates while productive intangibles had been subject only to the income tax on the yield, a much lighter charge.

Numerous minor amendments were also made.

Interpretation of the law.—Interesting questions arise as to how closely the interpretation of the state law should be influenced by the adjudication of the federal statute. When the Supreme Court of the United States declared, in the case of *Macomber v. Eisner* (252 U. S. 189), that stock dividends were not income, the state Comptroller ruled that the effect of the decision was to exempt stock dividends from the state tax also. The state law (section 350, subsection 8) defines dividends so as to include those made “in stock of the corporation.” As Professor Thomas Reed Powell has pointed out, the Comptroller appears “to have been guilty of considerable presumption” for the state legislature in imposing a direct tax is not subject to the limitations that restrict the federal Congress.

The only protection which recipients of stock dividends could find in the Federal Constitution against state income taxation must

be extracted from the due-process and equal-protection clauses of the Fourteenth Amendment. There are no decisions of the Supreme Court which proffer hope that these clauses would prove a shield.²¹

Administration.—For reasons which the politicians can best explain, administration of the personal income tax was placed in the hands of the state Comptroller instead of the State Tax Commission which was already administering the franchise tax law. Governor Miller has recently recommended that this anomaly of organization be removed²² and it is to be hoped that action will soon be taken to consolidate the functions now so widely scattered.

In the case of the personal income tax law the state Comptroller occupies roughly the same position as that of the Commissioner of Internal Revenue under the federal law. The interpretative material is of the same general character as that which is issued in administration of the national tax. Two volumes of regulations thus far have appeared. The first is entitled *Comptroller's Regulations Relating to the Income Tax Issued Pursuant to Chapter 627 of the Laws of 1919 Imposing Taxes upon and with Respect to Personal Incomes* (Albany, 1920). The second document is called *Supplement No. 1 to the Comptroller's Regulations Relating to the Income Tax, etc.* (Albany, 1920). This supplement was issued November 1, 1920, after the passage of the amendments of 1920.

In form the regulations follow closely those issued by the federal government. The similarity of the statutes makes this possible; and the practical result is a great convenience to the taxpayer. The Comptroller very wisely sought the co-operation of various accountants in drawing up the regulations.

Plan of the Book

Both the New York franchise tax on corporations and the

²¹*Bulletin of the National Tax Association*, May, 1920.

²²*New York Tribune*, January 3, 1921.

New York income tax on individuals frankly rest largely upon the federal law and regulations. This is sound and sensible and works out greatly to the assistance of the taxpayer. Ordinarily he will fill out his federal returns first and will then make whatever modifications are necessary to adapt his figures to the requirements of the state taxes. This book is arranged with the purpose of enabling the taxpayer to make these modifications—some of which are very important—with the minimum of expenditure in time and effort. On all points the book endeavors to tell the taxpayer what he must do in order to adjust his federal figures for use on his state return. As the federal procedure is fully discussed in the author's volume *Income Tax Procedure*, 1921, this book assumes the character of a supplement to that volume and all unnecessary repetition is avoided. The order of chapters follows that of the federal volume. All discussion is in the same relative position in the two books. However, although this book depends to a material degree upon the other volume, it does attempt to give a full and positive statement of the requirements of the state statutes. In general form it follows the plan found by experience to be satisfactory in the author's books on federal procedure. On each point it quotes *verbatim* the pertinent sections of the state statutes themselves and the exact language of the official interpretations of those statutes. Then follow the author's explanations, comments and criticisms.

Two further features of the book merit special mention. Chapter II is an attempt to summarize fully and accurately, yet briefly, the provisions of the state laws and their deviations from the federal statute. This should make it possible for anyone to obtain quickly a comprehensive idea of the characteristics and the peculiarities of the state taxes. The other feature to which special attention is directed is the inclusion of a full set of examples of the manner in which the various items of income and deductions should be handled, distinguishing federal and state procedure. Each item carries a cross-reference to the pages of the text which discuss the procedure

relative to it and each item is entered in its proper place on the relevant state return. The various state returns reproduced in Appendix A are properly filled out with the items taken from the income statements.

PART I
PERSONAL INCOME TAX

CHAPTER II

SUMMARY OF DIFFERENCES BETWEEN STATE AND FEDERAL PROCEDURE

Taxpayers before making up their New York state returns will have already prepared their federal returns, since the state returns do not have to be filed until a month after the due date of the federal return.

At the beginning of each chapter in this book dealing with the various items of income and deductions and the various classes of taxpayers, there appears a summary of the main points of difference between the treatment of the items in state and federal returns. In this chapter is given a summary of the principal differences, so that taxpayers who have one or more of the items affecting their particular case will be enabled to handle the differences without having to concern themselves with the many other items of difference which do not affect them.

It is suggested that taxpayers, when reading the following summary, check the items which may affect their New York returns. When compiling the New York returns, it will be necessary to refer only to the checked items.

Income

Income taxable under federal but exempt under state procedure.—The following items of income which are taxable or partly taxable under the federal law are entirely exempt under the state law:

1. Compensation of federal employees. (See page 48.)
2. Pensions paid by the United States. (See page 225.)
3. Compensation of persons in the federal military or naval forces during the present war. (See page 216.)

4. Compensation of receivers and referees in bankruptcy appointed by federal courts. (See page 49.)
5. Income received by officers of religious denominations, if used for charitable, and similar purposes. (See page 53.)
6. Interest accrued prior to January 1, 1919. The corresponding date in the federal law is March 1, 1913. (See page 233.)
7. Dividends declared payable to stockholders of record prior to January 1, 1919, even if received after January 1, 1919. The time when the profits were accumulated is of no significance under the state law. Under the federal law, dividends paid out of surplus accumulated prior to March 1, 1913, are not taxable. (See page 251.)
8. Interest on obligations of the United States. (See page 41.)
9. Interest on bonds of the War Finance Corporation. (See page 41.)
10. Interest on "investments" on which "investment tax" has been paid between June 1, 1917, and May 14, 1919. (See page 42.)
11. Undistributed profits of personal service corporations. (See page 252.)
12. Income accrued between March 1, 1913, and January 1, 1919.

NON-RESIDENTS.—Non-residents, moreover, are not taxable on the following income, which is taxable or partly taxable for federal purposes:

1. Income from annuities and pensions. (See page 374.)
2. Interest of any kind. (See page 374.)
3. Dividends. (See page 374.)
4. Profits from sales of stocks, bonds and other securities. (See page 376.)

5. Any income from a source outside New York. (See page 377.)

Unless any of the foregoing items are part of income from a business carried on in New York, in which case they would be subject to apportionment. (See page 391.)

Income exempt under federal but taxable under state procedure.—The following items of income which are exempt under federal law are taxable for state purposes:

1. Profit on exchange of convertible bond for stock. (See page 187.)
2. Profits from sale of certain vessels (section 23, paragraph 2, Merchant Marine Act of 1920). (See page 53.)
3. Profit due to unrealized appreciation of gift in hands of donor. (See page 201.)
4. Compensation of employees of the state of New York and its political subdivisions (with certain exceptions). (See page 215.)
5. Pensions paid by the state. (See page 225.)
6. "Christmas presents" received by employees. (See page 221.)
7. Interest on obligations of states other than New York and political subdivisions thereof. (See page 234.)
8. Dividends paid out of surplus accumulated prior to March 1, 1913. (See page 249.)
9. Dividends paid by personal service corporations from earnings accumulated since January 1, 1918, and prior to the beginning of the taxable year. (See page 252.)

Non-residents are taxable as to item (4), but not as to the other items unless they arise from a source within the state or from a business carried on within the state. Pensions (5) are not taxable to non-residents.

Deductions

Deductions allowed by federal but not allowed by state procedure.—The following deductions which are allowed in the federal return are not permitted in the state return:

1. Expenses incurred in producing non-taxable income. (See page 266.)
2. Traveling expenses in excess of a per diem allowance; the federal regulation requires the cost of living at home to be taken into consideration. (See page 274.)
3. State income taxes. (See page 292.)
4. Losses accrued between March 1, 1913, and January 1, 1919.

NON-RESIDENTS.—Non-residents, moreover, are not allowed under state procedure to deduct:

1. Any expense connected with income arising from sources without the state. (See page 381.)
2. Losses from sale of stocks, bonds or other securities. (See page 385.)
3. Losses arising from real or tangible personal property not having a situs within the state. (See page 385.) Unless any of the foregoing result from business carried on within the state of New York.
4. Contributions made to corporations or organizations not organized under the laws of the state of New York. (See page 386.)

Deductions not allowed by federal but allowed by state procedure.—The following deductions not allowed under the federal law are permitted to residents under the state law:

1. Interest on indebtedness incurred or continued to purchase or carry certain tax-exempt securities. (See page 291.)

2. Loss due to unrealized depreciation of gift in hands of donor. (See page 283.)

The above deductions will be permitted to non-residents only in so far as they arise from sources within the state or in connection with a business carried on within the state.

Personal Exemptions

The personal exemption of \$2,000 allowed to individuals, if married and living with husband or wife, under federal practice is divisible between them as they please, if separate returns are made. If separate state returns are made, the \$2,000 must be divided equally. (See page 36.)

Under federal practice, the status of the taxpayer on the last day of his taxable year determines his status for purposes of personal exemption and exemption for dependents. Under state rulings, the status at the time during the year which is most advantageous to the taxpayer, governs. (See page 35.)

Returns and Rates

Time for filing returns.—The time for filing federal returns is on or before the fifteenth day of the third month after the close of the taxable year. The state return must be filed on or before the fifteenth day of the fourth month thereafter. When reporting on a calendar year basis this means that federal returns are due March 15 and state returns April 15. (See page 64.)

Extensions.—Extensions of time for filing federal returns may in certain cases be granted by the local collector, but under state regulations extensions are generally granted only by the Comptroller, rarely by district officers. (See page 65.) In practice it is understood that extensions not exceeding 15 days may be granted by district officers.

Taxpayers living abroad.—Taxpayers living abroad have if necessary until 90 days after proclamation of peace to file federal returns, but no similar limitation has been fixed by the state. (See page 66.)

Joint returns—husband and wife.—It would appear that federal and state practice now permit joint returns of husbands and wives when one has a net loss which tends to reduce or wipe out the federal or the state tax which the other would pay if separate returns were filed. (See page 75.)

Change of fiscal year.—The date on which notice of a change of accounting period must be given is different under state and federal procedure. (See page 70.)

Change from cash to accrual basis.—Under federal practice application to change from cash to accrual basis, or vice versa, must be made to the Commissioner. Only after the Commissioner has given the authority to change will the Comptroller authorize a change for state purposes. (See page 153.)

Corporations do not file "income tax" returns.—Corporations file federal income tax returns, but are not required to file returns of taxable income under the state income tax law. (See page 63.)

Personal service corporations.—Personal service corporations are, in effect, classed as partnerships under the federal law, but under the state income tax law are classed as corporations and are not required to file "income tax" returns. (See page 63.)

Reconciliation of taxable net income.—Reconciliation between income reported in the federal returns and that reported in the state return is required to be given in the state return only. (See page 90.)

Rates of Tax

The federal tax consists of a normal tax and surtax of many brackets and increasing rates. The rates of state tax are (after deducting from income the personal exemptions): 1 per cent on the first \$10,000, 2 per cent on the next \$40,000 and 3 per cent on amounts over \$50,000. (See page 89.)

The federal method of computing the tax for a fiscal year which began in 1918 and ended in 1919 is to compute the tax on the income for a full year and then to prorate the tax. The state method is to prorate the income and compute the tax on the resulting amount of income. (See page 91.)

Surtax on sale of mines, etc.—The limitation on surtax on profits from the sale of oil wells, mines, etc., to 20 per cent of the selling price, provided for in the federal law, is not found in the state law. (See page 90.)

Non-Residents¹

Status determined by period of residence.—The status of an alien (as to whether he is a resident alien or non-resident alien) on the last day of his taxable year determines his status for tax purposes, under federal procedure. For state purposes, the status of a taxpayer at any time during the last six months of his taxable year determines whether he is a resident or a non-resident. (See page 59.)

Apportionment of income.—State practice requires special returns showing apportionment of income to sources within and without the state when a partnership or an estate or trust carries on business both within and without the state and has a non-resident member or beneficiary. Federal practice does not require apportionment. (See page 391.)

¹See also the general headings "Income," "Deductions," etc., in this chapter.

Payment of Tax

The federal law permits the payment of the tax in four equal instalments, but the state requires the payment of the tax in one sum at time of submission of return. (See page 96.)

Payment at Source

The federal law requires withholding in case of payments of interest on tax-free covenant bonds and on payments of a "fixed or determinable" nature to non-resident aliens. The state requires withholding only from personal service compensation paid to non-residents and to residents who have not filed a certificate of residence. (See page 133.)

Rates of withholding.—The federal rates of withholding from non-resident alien individuals is 8 per cent on fixed or determinable income and 2 per cent on tax-free covenant bond interest. The state rates of withholding are the same as the tax rates. (See page 133.)

Certificates of residence.—Certificates of residence, form 1078, are required from resident aliens, under federal practice, so that there need be no withholding by the withholding agent, who in turn files these certificates with the Commissioner. The certificates need be obtained but once. Under state practice, certificates of residence, form 101 (revised), are required of all residents who desire suspension of withholding. Certificates of non-residents claiming exemption, form 102 (revised), must also be filed each year with the withholding agent, who in turn files them with the Comptroller on or before April 15. (See page 133.)

Residents of Massachusetts.—Under state procedure no withholding is required from a resident of Massachusetts who files a certificate showing he is a resident of that state. There is no similar federal requirement. The tax which a resi-

dent of Massachusetts pays in that state on his income from New York sources generally more than offsets the New York tax on the same income. (See page 137.)

Due date of withholding returns.—Withholding returns are due and payment of the tax withheld must be made on or before March 1, under federal practice. Under the state regulation the corresponding date is April 15. (See page 142.)

Contract to assume income tax.—The federal law has no provision declaring illegal any contract to assume income tax, but section 385 of the state law specifically so provides. (See page 143.)

Significance of Dates January 1, 1919, and March 1, 1913

The first federal income tax law took effect March 1, 1913. Since property held on that date is regarded by the law as capital, the fair market value of property at March 1, 1913, if the property was acquired prior thereto, is used instead of cost in the following computations:

1. Depreciation and depletion of property. (See pages 321 and 327.)
2. Profit or loss arising from sale of property. (See page 205.)
3. Profit or loss arising from liquidation. (See page 185.)

Income accruing prior and collected subsequently to the incidence of the tax is not taxable. (See page 148.)

Expenses incurred prior and paid subsequently to the incidence of the tax are not deductible. (See page 268.)

The corresponding date in the state law is January 1, 1919, since the state income tax law took effect on that date.

A gift made in property is to be valued for federal purposes at cost, or value March 1, 1913, if acquired prior thereto (less proper depreciation). For state purposes, under present

practice, the fair market value at the time of the gift is to be used.

The donor, for state purposes, must report as profit or loss, the difference between the fair market value at date of gift, and cost, or fair market value at January 1, 1919, if acquired prior thereto. (See page 201.)

Credits for Taxes

The federal law permits the deduction of state income taxes from gross income. No similar deduction is permitted to residents of New York State. The state allows a non-resident to "credit" the amount of tax paid in the state or country of his residence imposed on his New York income against the New York tax imposed on the same income. (See page 292.)

Tax withheld at source.—The federal law permits non-resident aliens to credit the tax withheld at the source against the total tax due. The state allows similar credit in the case of all non-residents. (See page 399.)

British income tax.—British income tax withheld at the source on dividends may be credited against the total tax shown on the federal return, but similar credit is not permitted by the state. (See page 295.)

Tax paid by obligor under tax-free covenant.—Tax withheld on tax-free covenant bond interest may be credited on the federal return against the total tax, but no similar credit or deduction may be taken on the state return. (See page 299.)

Partnerships

Distributions.—The federal rulings do not specifically provide that each distribution to partners is to be deemed a ratable distribution of taxable and non-taxable income, but the state rulings do so provide. (See page 335.)

Credit for foreign income taxes.—In the federal return a member of a partnership may take credit for his share of any foreign taxes paid by the partnership, while in the state return such an allowance is permitted only to non-residents when the income so taxed arose from sources within the state of New York. (See page 396.)

Fiduciaries

Classification of estates.—The federal rulings classify estates or trusts as resident or non-resident, in accordance with the resident or non-resident status of the fiduciary. The state classification of estates or trusts, on the other hand, as resident or non-resident, depends upon the residence of the decedent at time of death or the residence of the creator of the trust at the time the trust was created. The determination of whether an estate or trust is resident or non-resident is important because non-resident estates are taxed in certain cases the same as non-resident individuals. (See page 342.)

Discretionary trusts.—When it is optional under the trust for the fiduciary to distribute the income or to accumulate it, the federal rulings tax to the fiduciary the income of such "discretionary" trust. The state, however, permits the actual fact of distribution or accumulation to govern. (See page 345.)

Miscellaneous

Special methods of valuing inventories.—Under the federal rulings, special methods of taking inventories peculiarly adapted to certain industries (tobacco, lumber, etc.) have been permitted to those industries. No such special rulings have been issued by the state. (See page 160.)

Replacement funds.—The federal rulings permit replacement funds to be established, instead of taking up the profit,

when compensation is received for the property lost through casualty. The state has not issued similar rulings. (See page 173.)

Taxation of capital gains.—Although a recent federal (lower) court decision has held in effect that the sixteenth amendment to the federal Constitution is not broad enough to warrant taxing capital gains, there is no inhibition in the state constitution against such taxation. (See page 211.)

Valuation of stock dividends.—The federal rulings provide for determining the cost of stock dividends of a character or preference materially different from the stock upon which the dividends are paid, as follows: The cost of the old stock is allocated to the old and new shares, respectively, in proportion to the market values of the old and new shares at the date of issuance of the new shares. Under the state practice the cost of the old shares, divided by the number of old and new shares taken together, gives the new cost of each old and new share. (See page 261.)

CHAPTER III

EXEMPTIONS

The New York tax, like the federal tax, is imposed upon "net income,"¹ a term minutely described in the law. It means the gross income of an individual (which includes earnings from personal services, businesses and trades, profits from sales of property, interest, rents, royalties, dividends,² etc.) less deductions for expenses, losses, interest, taxes, depreciation, etc.³

To determine the basis for the tax, there are certain personal exemptions to be deducted from "net income" as defined by the law.

The various types of taxable income included under the provisions of section 359 and the various kinds of allowable deductions permitted by section 360 are discussed in detail elsewhere in this book. This chapter is primarily concerned with neither the items of gross income nor the deductions, but rather with the exemptions.

The word "exemptions" is used in a broad sense and includes personal exemptions as well as items of income which are not taxable under the New York law.

Section 362 of the New York law provides for the same personal exemptions as section 216 (c) and (d) of the federal law. But, as will be pointed out later, the Comptroller has placed a different interpretation upon the language of this section.⁴

Unlike the federal law, the New York law does not provide for credits such as dividends, interest on Liberty bonds

¹Section 357.

²Section 359.

³Section 360.

⁴See *Income Tax Procedure*, 1921, page 32 for federal regulations. The federal law exempts dividends from the normal tax only, not from the surtax.

and taxes paid at the source. As this state imposes a franchise tax upon corporations, which is in effect an income tax,⁵ New York is guilty to a certain extent of imposing a double tax upon this type of income.

As the subject of non-residents is treated in a separate chapter of this book, the exemptions treated herein apply only to residents.

Summary of Differences Between State and Federal Procedure⁶

Personal exemptions.—The provisions of the state law providing for personal exemptions vary from those of the federal law. In certain minor particulars the official interpretation is also different. These changes, however, affect only those taxpayers who (1) as husband and wife, render separate returns, or (2) have changed their marital condition or status with reference to dependents during the course of the taxable year. (See page 35.)

Income taxable by federal but exempt by state government.—Income which is exempt under the federal statute is also exempted by the state, with the exception of the items referred to in the next paragraph. In addition the following items are entirely exempt under the state law :

1. Interest on certain obligations of the United States.
(See page 41.)
2. Interest on bonds of the War Finance Corporation.
(See page 41.)
3. Amounts received through the War Risk Insurance Act or any law for the benefit or relief of injured or disabled members of the military or naval forces of the United States.⁷ (See page 39.)

⁵*New York v. Knapp* (Court of Appeals, decided November 23, 1920).

⁶This chapter deals only with exemptions applying to residents. For non-residents, see Chapter XVIII.

⁷Amounts received since June 25, 1918, from war risk insurance are not subject to federal income tax. Reg. 45, Art. 72.

4. Compensation received from the United States by certain officers and employees thereof. (See page 48.)
5. Income received by officers of certain charitable and religious institutions. (See page 53.)
6. Interest upon securities on which the investment tax has been paid. (See page 42.)

Income exempt by federal but taxable by state government.—Certain items which are exempt under the federal statute become taxable for state purposes, as follows:

1. Interest on obligations of states other than New York, or the municipal corporations or other subdivisions thereof. (See page 42.)
2. Compensation paid its officers and employees by the state of New York or any political subdivision thereof. (See page 51.)
3. Profits from the sale of vessels covered by the Merchant Marine Act of June 5, 1920. (See page 53.)

Credits.—The New York State tax does not impose normal rates plus surtax rates. There is no normal rate from which certain items are exempt while still subject to surtaxes. The rates are graduated, it is true, but each item of income is either taxable or entirely exempt from the tax. If it is exempt at all it is exempt from all the rates. Consequently there is no need for the device of "credits" used in the federal law to render certain items of personal income, such as dividends and some kinds of interest, at the same time both exempt from the normal and subject to the surtaxes.

Personal Exemptions

The sections of the state law granting personal exemptions are almost identical with those appearing in the federal statute.⁸ The state law does, it is true, specifically require the

⁸Federal law, section 216 (c).

\$2,000 exemption to be equally divided between husband and wife if separate returns are made. Moreover, the state does not insist that the status of the individual at the end of the year shall determine his exemption in case a larger exemption would result if his status at some time during the year be accepted.

LAW. Section 362. The following exemptions shall be allowed to any taxpayer:

1. In the case of a single person, a personal exemption of one thousand dollars, or in the case of the head of a family or a married person living with husband or wife, a personal exemption of two thousand dollars. A husband and wife living together shall receive but one personal exemption of two thousand dollars against their aggregate net income; and in case they make separate returns, the personal exemption of two thousand dollars shall be equally divided between them.

2. Two hundred dollars for each person (other than husband or wife) dependent upon and receiving his chief support from the taxpayer, if such dependent person is under eighteen years of age or is incapable of self-support because mentally or physically defective.⁹

The first \$1,000 of taxable income is always exempt; a second \$1,000 is exempt in case the taxpayer is the head of a family or a married person living with husband or wife; and \$200 additional is exempt for each person "dependent" upon the taxpayer.

⁹[Former Procedure] Section 362 prior to the amendment of 1920 contained a third paragraph reading as follows:

"A taxpayer receiving salary, wages or other compensation from the United States as an official thereof, exempt from taxation under this article, shall be entitled to only so much of the personal exemption provided for in this section as is in excess of the aggregate amount of such salaries, wages or other compensation."

This limitation on the personal exemptions was removed by the repeal of paragraph 3 by chapter 58, Laws 1920, effective as to 1919 returns.

Section 362 (1) read:

" . . . and in case they make separate return, the personal exemption of two thousand dollars *may be taken by either or divided between them.*"

The words in italics were replaced by "shall be equally divided between them," as above quoted.

Test of dependency.—

REGULATION. A taxpayer receives an exemption of \$200 for each person (other than husband or wife), whether related to him or not and whether living with him or not, dependent upon and receiving his chief support from the taxpayer, provided the dependent is either (a) under eighteen years of age or (b) incapable of self-support because defective. The exemption is based upon actual financial dependency and not mere legal dependency and may accrue to a taxpayer who is not the head of a family. But a father whose children receive half or more of their support from a trust fund or other separate source is not entitled to the exemption. (Art. 208.)

“Head of a family” defined.—

REGULATION. A head of a family is entitled to a personal exemption of \$2,000. A head of a family is a person who actually supports and maintains in one household one or more individuals who are closely connected with him by blood relationship, relationship by marriage, or by adoption, and whose right to exercise family control and provide for these dependent individuals is based upon some moral or legal obligation. In the absence of continuous actual residence together, whether or not a person with dependent relatives is the head of a family within the meaning of the statute must depend on the character of the separation. If a father is absent on business or at war, or a child or other dependent is away at school or on a visit, the common home being still maintained, the additional exemption applies. If, moreover, through force of circumstances a parent is obliged to maintain his dependent children with relatives or in a boarding house while he lives elsewhere, the additional exemption may still apply. A resident alien with children abroad is not entitled to the exemption of a head of a family. (Art. 206.)

The foregoing ruling requires residence “in one household,” using the same language as the federal regulation, but it is to be expected that the state will abandon this requirement, as has been done by the federal authorities.¹⁰

Status during year determines exemption.—The state regulation is much more liberal than the federal,¹¹ in that the status of the taxpayer at any time he may select *during the taxable year* determines his right to the additional \$1,000 per-

¹⁰*Income Tax Procedure*, 1921, page 34.

¹¹Reg. 45, Art. 305.

sonal exemption and the \$200 for each dependent, rather than the status on the last day of the taxable year.

REGULATION. The status of the taxpayer during the taxable year determines his right to an additional exemption and to exemption for dependents. If at any time during the taxable year he is the head of a family, the personal exemption of \$2,000 may be taken. If he is the chief support of a dependent who is under eighteen years of age, or incapable of self-support because mentally or physically defective, the exemption of \$200 may be taken. . . . If an individual dies during the taxable year, his executor or administrator in making a return for him is entitled to claim his full personal exemption according to the status of the decedent.¹² If a husband or wife so dies and the joint personal exemption is used by the executor or administrator in making a return for the decedent, an undiminished personal exemption according to the status of the survivor during his (or her) taxable year subsequent to such death may be claimed in the survivor's return. (Art. 209.)

A married person whose husband or wife died during the year, who was a widow or widower at the end of the year, and not a "head of a family," under the federal regulation would be permitted a personal exemption of only \$1,000; but the state would allow \$2,000.

Division of exemption between husband and wife.—

REGULATION. A husband and wife living together during the taxable year may receive but one personal exemption of \$2,000, which may be taken on a joint return or equally divided if separate returns be made. . . . (Art. 209.)

This regulation is a paraphrase of the law quoted on page 34. It is to be noted that under the federal procedure if husband and wife make separate returns, the \$2,000 exemption is "divisible as they please," whereas the state requires that it be "equally divided" if separate returns be made.

What constitutes "living with husband or wife"?—

REGULATION. In the case of a married man or married woman the joint exemption replaces the individual exemption only if the man lives with his wife or the woman lives with her husband.

¹²See Chapter XVII, "Fiduciaries."

In the absence of continuous actual residence together, whether or not a man or woman has a wife or husband living with him or her within the meaning of the statute must depend upon the character of the separation. If merely occasionally and temporarily a wife is away on a visit, or a husband is away on business, the joint home being maintained, the additional exemption applies. The unavoidable absence of a wife or husband at a sanatorium or asylum on account of illness does not preclude claiming the exemption. If, however, the husband voluntarily and continuously makes his home at one place and his wife hers at another, they are not living together for the purpose of the tax law, irrespective of their personal relations. A resident alien with a wife residing abroad is not entitled to the joint exemption. (Art. 207.)

Income of wife during year prior to marriage.—

RULING. It is stated in your letter of February 4, that a girl earned \$600 from January 1 to June 30, 1919; that on July 31, 1919, she married; that her husband had an income of \$1,600 for the year 1919. You inquire if the husband must include in his return the income of his wife before marriage in order to claim the \$2,000 exemption, and if the answer is in the negative, if they are exempt from making returns.

You are advised that the exemption of \$2,000 granted to a married person living with wife is a joint exemption and replaces two separate single exemptions. A husband and wife may include their aggregate net income in a single joint return. If that is done, one personal exemption of \$2,000 is allowed. If they do not join in rendering a single return but have an aggregate net income of \$2,000 or more for the taxable year, each must render a return. . . . If separate returns are made, . . . they [shall] divide [the \$2,000 exemption] equally . . . between them.

In the case which you mention either of two courses may be followed:

1. They must file a single joint return and include the amount of income earned by the wife before marriage, in which case they are entitled to a joint exemption of \$2,000, or
2. They must each file a return in which case they [shall] divide the \$2,000 exemption [equally] between them. . . . (Official ruling, dated February 6, 1920.)

PERSONAL EXEMPTIONS OF WARDS, BENEFICIARIES AND ESTATES.—Beneficiaries receiving their income from estates are entitled to claim exemption according to their status during the year. The fiduciary when making returns is allowed

to deduct this personal exemption from the amount of income derived from the property of which he has charge, in favor of each beneficiary who has not claimed a personal exemption independently or through another trustee. (Section 369.)

When the estate is taxed to the fiduciary, a deduction of \$1,000 (no exemption for dependents) is allowed in computing the tax upon the estate. [Section 365 (3).]¹³

Items of Income Which Are Not Taxable

Like the federal law, the New York law exempts certain classes of income, but the content of the classes differs in certain particulars.

Life insurance—extent to which exempt.—

WHEN PAID TO BENEFICIARIES.—

LAW. Section 359. The term "gross income":

2. Does not include

a. The proceeds of life insurance policies and contracts paid upon the death of the insured to individual beneficiaries or to the estate of the insured.

The federal rulings have interpreted the term "individual beneficiary" to include a partnership beneficiary. It is to be expected that the state will follow the federal interpretation.

REGULATION. (a) Upon the death of an insured the proceeds of his life insurance policies, whether paid to his estate or to individual beneficiaries, directly or in trust, are excluded from the gross income of the beneficiary. (Art. 72.)

WHEN PAID TO THE INSURED.—

LAW. Section 359. The term "gross income":

2. Does not include

b. The amount received by the insured as a return of premium or premiums paid by him under life insurance, endowment or annuity contracts, either during the term or at maturity of the term mentioned in the contract or upon surrender of the contract.

¹³See Chapter XVII.

REGULATION. . . . (b) During his life only so much of the amount received by an insured under life, endowment or annuity contracts as represents a return, without interest, of the value thereof on January 1, 1919, plus the premiums paid by him thereafter, is excluded from his gross income. . . . (Art. 72.)

Under the federal regulation¹⁴ the cost is deemed to be the premiums paid without interest, even in the case of a very old policy.

The state regulation calls for a valuation at January 1, 1919, which affords a more logical basis.

Accident, health and war risk insurance exempt.—

LAW. Section 359. The term "gross income":

2. Does not include. . . .

e. Any amount received through accident or health insurance or under workmen's compensation acts, as compensation for personal injuries or sickness, plus the amount of any damages received whether by suit or agreement on account of such injuries or sickness, or through the war risk insurance act or any law for the benefit or relief of injured or disabled members of the military or naval forces of the United States.¹⁵

REGULATION. . . . (c) The amounts received by an insured or his estate or other beneficiaries through accident or health insurance or under workmen's compensation acts as compensation for personal injuries or sickness are excluded from the gross income of the insured, his estate and other beneficiaries. Any damage recovered by suit or agreement on account of such injuries or sickness are similarly excluded from the gross income of the individual injured or sick, or of his estate or other beneficiaries entitled to receive such damages. Amounts received from any allotments, family allowances, compensation, or death or disability insurance payable under the War Risk Insurance Act of September 2, 1917, as amended, are excluded from gross income. (Art. 72.)

"NAVAL OR MILITARY FORCES" DEFINED.—

LAW. Section 350. . . . 3. The words "military or naval forces of the United States" include the marine corps, the coast guard, the army nurse corps, female, and the navy nurse corps, female, but this shall not be deemed to exclude other units otherwise included within such words. . . .

¹⁴Reg. 45, Art. 72.

¹⁵For definition of "military or naval forces," see page 39.

Gifts¹⁶ and inheritances exempt.—

LAW. Section 359. The term "gross income":

2. Does not include.

c. The value of property acquired by gift, bequest, devise or descent (but the income from such property shall be included in gross income).

REGULATION. Money and real or personal property received as gifts, or received under a will or under statutes of descent and distribution, are exempt from tax, although the income therefrom derived from investment, sale or otherwise is not. An amount of principal paid under a marriage settlement is a gift. (Art. 73.)

WHEN A SO-CALLED PENSION IS A GIFT.—The federal authorities at first held pensions from the Carnegie Foundation taxable, but later held them to be gifts and, as such, not taxable.

RULING. Upon reconsideration of the opinion submitted by you upon the above named subject and the last opinion of the solicitor of internal revenue on this subject, this office rules that pensions or retirement allowances made to teachers or to the widows of teachers by the Carnegie Foundation for the Advancement of Teaching, do not constitute taxable income under the state income tax law, whether paid to a resident or to a non-resident. (Letter to Root, Clark, Buckner & Howland, New York, N. Y., signed by Mark Graves, Director, by I. Sack, Assistant Director, Chief, Audit Division, and dated October 21, 1920.)

TEACHERS' PENSIONS IN THE CITY OF NEW YORK NOT TAXABLE.¹⁷—The Attorney-General has held pensions of school teachers in the city of New York to be non-taxable, on the ground that under the New York charter, which is a special act, such pensions were exempt from tax, and the provisions of the charter were not repealed by the tax law, which is also a special act.

Bonus from state or federal government exempt.—

RULING. Replying to your inquiry of January 6, you are advised that payments of War Service Gratuities are held to be gifts from the governments by which they are paid and therefore exempt from

¹⁶For taxability to donor of appreciation in value of gift, see page 201.

¹⁷See page 226 regarding pension receipts.

taxation under the provisions of the personal income tax law of New York. (Official ruling, dated Jan. 9, 1920.)

All interest on obligations of United States and its possessions exempt.—

LAW. Section 359. The term "gross income":

2. Does not include

d. Interest upon the obligations of the United States or its possessions;

This simplifies the procedure under the state law as compared with the federal law. All such interest is exempt and is not included in computing net income. It will be recalled that the federal government taxes the interest on some of its loans. The amount of non-taxable income must, however, be reported.¹⁸

INTEREST ON FARM LOAN BONDS EXEMPT.—

LAW. Section 359. The term "gross income":

2. Does not include

d. Interest upon securities issued under the provisions of the federal farm loan act of July seventeen, nineteen hundred and sixteen;

INTEREST ON BONDS OF WAR FINANCE CORPORATION EXEMPT.—

LAW. Section 359. The term "gross income":

2. Does not include

d. Interest upon bonds issued by the war finance corporation;¹⁹

Interest on obligations of the state of New York and its "political subdivisions" exempt.—

LAW. Section 359. The term "gross income":

2. Does not include

d. Interest upon the obligations of the state of New York or of any municipal corporation or political subdivision thereof;

¹⁸Item 10, page 1, form 201; also instruction E, page 1 of instructions.

¹⁹Interest on \$5,000 principal amount of bonds of the War Finance Corporation and all interest on Farm Loan bonds is exempt under the federal procedure.

"POLITICAL SUBDIVISION" DEFINED.—

REGULATION. . . . The term "political subdivision" denotes any division of the State made by the proper authorities thereof acting within their constitutional powers for the purpose of carrying out a portion of those functions of the State which by long usage and the inherent necessities of government have always been regarded as public. Political subdivisions of the State, within the meaning of the exemption, include special assessment districts so created, such as road, water, sewer, gas, light, drainage, school and similar districts and divisions. The purchase by the State or any political subdivision thereof of property subject to a mortgage does not render the debt an obligation of the State, or of such political subdivision, and the interest upon it does not become exempt from taxation, whether or not the purchaser assumes the payment of the debt. (Art. 74.)

It is to be noted that interest on the obligations of other states and their subdivisions, although exempt under the federal law,²⁰ are taxable under the New York law.

Interest on investments on which "investment tax" has been paid is exempt.—

LAW. Section 359. The term "gross income":

2. Does not include

d. Interest upon investments upon which the tax provided for in section three hundred and thirty-one²¹ of this chapter²² has

²⁰Federal law, section 213 (b-4).

²¹Section 331, article XV reads:

Payment of tax on investments.—"After this article takes effect, any person may take or send to the office of the comptroller of this state any investment, and may pay to the state a tax at the rate of twenty cents per year on each one hundred dollars or fraction thereof of the face value of such investment for one or more years not exceeding five, under such regulations as the comptroller may prescribe, and the comptroller shall thereupon affix stamps hereinafter provided for, to such investment, which stamps shall be duly signed by the comptroller or his duly authorized representative and dated as of the date of the payment of such tax. The comptroller shall keep a record of such investment together with the name and address of the person presenting the same and the date of payment of the tax.

"All such investments shall thereafter be exempt from all taxation in the state or any of the municipalities or local divisions of the state except as provided in sections twenty-four to twenty-four-g, both inclusive, one hundred and eighty-seven, one hundred and eighty-eight and one hundred and eighty-nine of this chapter, and in articles ten and twelve of this chapter, for the period of years from the payment of such tax for which such tax shall have been paid and such stamps affixed."

²²All of article XV of the tax law, as amended, of which section 331 was a part, was repealed by chapter 646 of the Laws of 1920, effective May 10, 1920.

heretofore been paid since June first, nineteen hundred and seventeen, during the period of years for which such tax shall have been paid.

The "investment tax" was a special tax (20 cents on each \$100 or fraction thereof of the face value of the investment for each year of exemption, not exceeding five), payment of which exempted the investment for a limited period from personal property tax in the state of New York.

Exemption could be secured for one or more years, not exceeding five, from date of payment of the tax, at any time after June 1, 1917, when the investment tax law became effective.

It was necessary to present the "investment" to the Comptroller "who shall affix stamps of the proper denominations, equal in face value to the amount of tax paid, to the investment, and shall cancel the same by the seal of his office or by such other canceling device as he may prescribe." (Section 332.)

The definition²³ of "investment" in the law included any bond, etc., forming part of a series of similar bonds, payable one year or more from their date of issue either secured or unsecured, but not including:

²³Section 330, article XV, reads:

Definitions.—"The word 'investments,' as used in this article, shall include:

"Any bond, note, debt, debenture, equipment bond or note, or written or printed obligation, forming part of a series of similar bonds, notes, debts, debentures, written or printed obligations, which by their terms are payable one year or more from their date of issue and which are either secured by a mortgage, pledge, deposit, or deed of trust, of real or personal property, or both, or which are not secured at all; excepting bonds of this state or any civil division thereof and such bonds, notes, debts, debentures, written or printed obligations, which are secured by a deed of trust or mortgage recorded in the state of New York on real property situated wholly within the state of New York; excepting also such bonds, notes, debts, debentures, written or printed obligations held as collateral to secure the payment of investments taxable under this article or of bonds taxable under article eleven of this chapter; and excepting also such proportion of a bond, note, debt, debenture or written or printed obligation, secured by deed of trust or mortgage recorded in the state of New York of property or properties situated partly within and partly without the state of New York as the value of that part of the mortgaged property or properties situated within the state of New York shall bear to the value of the entire mortgaged property or properties."

1. Bonds of the state of New York or of any civil division thereof.
2. Obligations secured by a deed of trust or mortgage, recorded in the state of New York, on real property situated wholly within the state.
3. Obligations held as collateral to secure the payment of investments taxable under this article or bonds taxable under the mortgage tax law.
4. Such proportion of the obligation secured by deed of trust or mortgage on property situated partly within and partly without the state of New York, as the value of the mortgaged property situated within the state of New York bears to the value of the entire mortgaged property.

Prior to the enactment of the investment tax law referred to above, the secured debts tax law and the mortgage tax law provided exemption from taxation by payment of a certain sum. Taxpayers relied on the provisions of these laws and made the payments necessary to exempt such securities. The investment tax law was enacted in 1917, requiring payments as outlined in the preceding paragraphs, but limiting the exemption to five years.

Section 359 of the personal income tax law quoted above, in its enumeration of items not included in gross income, specifies interest on investments which have paid the tax required under the investment tax law, but no mention is made of those investments which were exempted under the previous secured debts law nor of the investments exempted under the mortgage tax law.

The legislators have been severely criticized for failing to apply the exemption in section 359 to investments other than those under the investment tax law, and it has been alleged that, in fact, the promise made by the state of exemption from taxation is a "mere scrap of paper" to anyone who paid his tax in good faith prior to June 1, 1917.²⁴

²⁴*Wall Street Journal*, May 26, 1919.

The following ruling by the Attorney-General relates the history of these laws and sets forth the position of the state as to the limitations of the exemption.

RULING. In accordance with your oral request I have considered the question: Is any income tax payable upon the income derived from mortgages on which the mortgage tax has been paid under Article XI of the Tax Law, or secured debts upon which the tax was paid under former Article XV of the Tax Law?

Under §251 of the Tax Law, mortgages on real property taxed by Article XI "shall be exempt from other taxation by the State . . . except"—specified parts of the Tax Law. Under former §334 of the Tax Law secured debts (as defined in former §330) upon which the tax was paid, became exempt "from all taxation in the State except" specified sections. Under the present §331, investments (as defined in §330) upon which the investment tax is paid, became similarly exempted. These exemptions were provided for in the statutes at different times to encourage the voluntary payment of taxes upon personal property on which it was always very easy to avoid local taxation. The consideration for the exemption varied in the three statutes. Under the Mortgage Tax Law (Article XI) by payment of fifty cents upon one hundred dollars of principal debt, a perpetual exemption for that debt was secured. Under the Secured Debt Tax Law (Article XV of the Tax Law) as originally enacted (Laws 1911, Chap. 802), on payment of fifty cents on each hundred dollars, a perpetual exemption was secured. This article was amended (Laws 1915, Chap. 465) raising the price of exemption to seventy-five cents on the hundred dollars and cutting down the exemption to five years. A new article under the same title was substituted (Laws 1916, Chap. 261) but the tax remained at the rate of seventy-five cents on each hundred dollars, and the exemption remained fixed at five years. The present Investment Tax Law took the place of the Secured Debt Tax Law as Article XV of the Tax Law (Laws of 1917, Chap. 700) and investments as defined may pay a voluntary tax of twenty cents on the hundred dollars for each year (not exceeding five) and exemption is secured for the number of years the tax is paid.

I think the fact that persons paying under the Mortgage Tax Law and the former Secured Debt Tax Law got much more for their money than those who paid after June 1, 1917, under the Investment Tax Law, must have been in the minds of the framers of the Income Tax Law, when §359, paragraph 2 (d), was made to exempt from the income tax, by excluding from the definition of gross income, the income from investments upon which the tax has been paid since June 1, 1917, under the Investment Tax Law, while at the same time the income from mortgages and the income

from secured debts were left unmentioned in the category of exempt property.

The fact that the legislature specifically mentioned as exempt the income from one class of exempt property and omitted to exempt the income from two other classes, indicates that it was not the legislative intention that the two latter should have the benefit of the exemption. The rule of statutory construction *inclusio unius est exclusio alterius* controls and I must construe the statute just as if the legislature had expressly stated that it did not intend to exempt from the Income Tax income from mortgages or secured debts.

The exemption granted by the mortgage tax was an exemption from other taxation of the mortgage and the debts and obligations secured thereby and the paper writings evidencing the same (Tax Law §251) and the exemption granted by the secured debt tax was an exemption of the secured debts upon which the tax was paid (Tax Law former §331). The exemption of a mortgage and the exemption of a secured debt are not necessarily the exemption of income derived therefrom any more than the exemption of a farm implies the exemption of the income derived therefrom. The fact that income taxes have been rather rare in this country results in a dearth of authorities on this special subject, but I have no doubt that the courts will hold that in taxing income from secured debts or from mortgages, the State has not violated its contract not to tax those debts or those mortgages. The Supreme Court of North Carolina many years ago held that the exemption of bank stock from other than a fixed tax did not prevent the levying of an income tax upon the dividends which might be paid to shareholders. (*State v. Petway* 2 Jones Eq. 596.) When a dividend is paid on stock or interest is paid on a mortgage, it ceases to be part of the obligation and becomes cash in the hands of the recipient and as such is taxable as income at the will of the legislature. Under the Federal Income Tax Law a firm of exporters relied on the provision of the United States Constitution that "no tax or duty shall be laid on articles exported from any state" as the basis of their claim that their income from exports was immune. The United States Supreme Court pointed out that an income tax laid generally on net income did not violate the constitutional provisions, because it affected a net income derived from the business of exporting. The court said: "It is not laid on income from exportation because of its sources or in a discriminative way, but just as it is laid on other income. The words of the act are 'net income arising or accruing from all sources.' There is no discrimination. At most, exportation is affected only indirectly and remotely. The tax is levied after exportation is completed, after all expenses are paid and losses adjusted, and after

the recipient of the income is free to use it as he chooses." (Peck & Company v. Lowe, 247 U. S. 165-174.)

It seems to me that the logic in the question before me is similar. The individual is taxed on his income from all sources and an exemption granted to a mortgage or a secured debt does not cover the same property.

I am strengthened in this construction of the statute by the well settled rule that exemption statutes will be construed most strictly against persons claiming their benefit and that neither the right of taxation nor any other power of sovereignty which the community have an interest in preserving undiminished, will be held to be surrendered, unless the intention to surrender is manifested in words too plain to be mistaken.

In sum, it is my opinion that the income from mortgages and "secured debts," not being specifically exempted as is the income from "investments," remains subject to the income tax and may not be excluded in the computation of gross income. (Attorney-General's Income Tax Letter No. 8, dated June 19, 1919.)

INVESTMENT TAX MUST HAVE BEEN PAID BETWEEN JUNE 1, 1917, AND MAY 14, 1919.—

REGULATION. Among income exempt from tax is interest upon . . . investments upon which the tax provided for in section 331 of the Tax Law has been paid between June 1, 1917, and May 14, 1919, during the period of years for which such tax shall have been paid. However, the income from securities (1) upon which the investment tax was paid after May 14, 1919, or (2) upon which the secured debt tax or the mortgage tax was paid, is not exempt. . . . (Art. 74.)

June 1, 1917, is the date of the enactment of the investment tax law, and May 14, 1919, is the date of the enactment of the personal income tax law.

The effect of the above regulation in an actual case is shown by the following:

RULING. Answering your inquiry of March 6, you are advised that a person owning a New York Central 20 year \$1,000 6% convertible bond on which the Investment Tax was paid September 24, 1918, for the period of one year will report as income for 1919, the amount of \$6.00, that being the amount of interest which accrued between September 24, 1919 and November 1, 1919, the date on which the coupon for six months' interest became due and payable. (Letter to David W. Swain, New York, N. Y., signed by Eugene M. Travis, Comptroller, by Mark Graves, Director, Income Tax Bureau, and dated March 8, 1920.)

Certain dividends exempt.—The state law, like the federal,²⁵ exempts the following classes of dividends:

FEDERAL LAND BANK AND NATIONAL FARM LOAN ASSOCIATION DIVIDENDS EXEMPT.—

REGULATION. The income derived from dividends on stock of Federal land banks and national farm loan associations and from interest on farm loan bonds is excluded from gross income. (Art. 75.)

FEDERAL RESERVE BANK DIVIDENDS.—

REGULATION. The dividends received on the stock of federal reserve banks are excluded from gross income. Dividends paid by member banks, however, are treated like dividends of ordinary corporations. (Art. 76.)

Compensation of federal employees.—In conformity with the theory of not taxing the “instrumentalities” of another sovereign, the state exempts all compensation received from the federal government. It must be remembered, however, that compensation of state officers and employees, although exempt under the federal law, is taxable under the state law. The state exempts all income of army and navy officers, while the federal law taxes all in excess of \$3,500 per annum.²⁶

LAW. Section 359. The term “gross income”:

2. Does not include

f. Salaries, wages and other compensation received from the United States of officials or employees thereof, including persons, in the military or naval forces of the United States. . . .

REGULATION. Salaries, wages and other compensation received from the United States by officials or employees thereof, whether in a civilian capacity or in the military or naval service, including the fees and commissions of receivers and referees appointed by Federal courts, are exempt from taxation and should be excluded from gross income. Salaries, wages and other compensation of persons engaged in the operation of railroads, telegraphs, telephones and cables during the period of Federal control and operation are regarded as paid by the United States, and likewise exempt from taxation. The amount

²⁵Reg. 45, Arts. 75, 76.

²⁶Federal law, section 213 (b-8).

received must, however, be reported on the return of income. (Art. 78.)

Under the federal law,²⁷ compensation not in excess of \$3,500 per annum for active service during the present war is exempt.

COMPENSATION OF RECEIVERS AND REFEREES IN BANKRUPTCY EXEMPT.—It is to be noted that article 78 quoted above specifically exempts “fees and commissions of receivers and referees appointed by Federal courts.”

RULING. Answering specifically the inquiry raised in your letter, you are advised that the compensation received by a receiver or trustee in bankruptcy from the bankrupt estate, is not subject to taxation under the personal income tax law. (Letter to Lybrand, Ross Bros. & Montgomery, signed by Mark Graves, Director, Income Tax Bureau, dated February 3, 1920.)

Such compensation, however, is taxable under the federal rulings.²⁸

COMPENSATION OF EMPLOYEES OF RAILROADS, TELEGRAPHS, TELEPHONES AND CABLES.—The Attorney-General has held²⁹ that “the earnings during the time of control and operation by the United States of employees of telephone and telegraph lines, cables and railroads are excluded from gross income.”

Salaries of employees of the Pullman Company during federal control have been held to be exempt.³⁰ But compensation of an attorney receiving a fee or retainer from a railroad, if such attorney was not a “member of the legal staff of the railroad,” was held to be taxable.³¹

A definite statement differentiating between the roads under federal control and those not so controlled is contained in the following:

²⁷Section 213 (b-8).

²⁸See *Income Tax Procedure*, 1921, page 297.

²⁹Attorney-General's Income Tax Letter No. 6, dated June 10, 1919.

³⁰Official ruling, November 18, 1919.

³¹Letter to the Corporation Trust Company signed by Mark Graves, Director, Income Tax Bureau, dated January 30, 1920.

RULING. The attorney-general has ruled that officers and employees of railroads which were taken over by the United States Railroad Administration and whose compensation was paid by the director-general of railroads, are officers or employees of the United States within the meaning of the New York State income tax law, and their compensation as such officers or employees, during the period of federal control, is exempt from taxation under the New York law.

Your attention is called, however, to the fact that this refers only to (a) officers and employees of railroads taken over by the Railroad Administration, and (b) to compensation paid by the Railroad Administration to such officers and employees. It does not relate to the officers and employees of roads not taken over by the Railroad Administration, or to compensation paid to the corporate officers and employees by the railroad company and not by the director-general.

It follows, therefore, that any compensation paid to officers and employees from the corporate funds of a railroad corporation whose properties were taken over by the Railroad Administration, and all compensation paid to officers and employees of other railroads, is subject to tax.

Railroads which were not taken over by the Government will be required to file returns of information concerning all payments of salaries and wages in the same manner as are other employers. Railroads which were under federal control will be required to file a return of information concerning all payments of salaries and wages not paid by the Railroad Administration.

May I suggest that you advise your employees and officers concerning their taxability under the New York State income tax law? I shall be glad to give you any further information on the subject that you may desire. (Circular letter to railroads operating or having any office within the state of New York, signed by Comptroller Eugene M. Travis, and dated March 2, 1920.)

COMPENSATION RECEIVED FROM CORPORATIONS WHOSE STOCK IS OWNED BY THE UNITED STATES.—The Attorney-General has ruled³² that compensation paid by corporations whose stock is owned by the United States is to be regarded as if received from any ordinary corporation and is, therefore, taxable. The "corporate fiction" is not to be disregarded in such cases. The corporations specifically mentioned are: United States Shipping Board Emergency Fleet Corporation,

³²Attorney-General's Income Tax Letter No. 17, dated February 3, 1920.

United States Housing Corporation, United States Food Administration Grain Corporation, United States Sugar Equalization Board, Inc., De La Vergne Machine Company.

RULING. . . . Care should be taken to distinguish between departments of the government and their employees and these corporations. The United States Shipping Board and the United States Food Administration are departments of the Government, and their members and employees are officials and employees of the United States. But the United States Shipping Board Emergency Fleet Corporation and the United States Food Administration Grain Corporation are distinct persons. In any given case, care should be taken to make sure whether the employee is an employee of the Government, exempted as to his salary, or an employee of the Corporation, and taxable. (Attorney-General's Income Tax Letter No. 17, dated February 3, 1920.)

Compensation of certain state officers exempt.—Following the decision by the United States Supreme Court³³ that the salaries of federal judges and the President of the United States could not be taxed because the federal Constitution prohibited any diminution of such salaries during continuance in office, the Attorney-General has ruled that the "state income tax should not be levied against the salaries of officers protected by . . . the Constitution."

RULING. The officers so protected include the Secretary of State, the Comptroller, the State Treasurer, the Attorney General, the State Engineer and Surveyor, the Superintendent of Public Works, the three Assistant Superintendents of Public Works, the Superintendent of State Prisons, the Clerks of the Court of Appeals and the Appellate Divisions of the Supreme Court, and the County Judges and Surrogates. This list is not exclusive. There may be others whom I have overlooked in a hasty examination of the Constitution. (Attorney-General's Income Tax Letter No. 38, dated August 30, 1920.)

The Attorney-General of the state has also followed with respect to state officers the opinion of the United States Attorney-General, who ruled that judges appointed since the enactment of the tax law are taxable.

³³*Evans v. Gore*, 253 U. S. 245.

Income of states, etc., from public utilities, etc., exempt.—

The state law has no provision similar to that in the federal⁸⁴ law exempting the income derived from a public utility accruing to a state, but the Comptroller has issued the following regulation which is identical with the federal regulation.⁸⁵

REGULATION. In the case of a public utility acquired, constructed, operated or maintained by a taxpayer under contract with any State, Territory, or political subdivision thereof, or with the District of Columbia, containing an agreement that a portion of the net earnings of such public utility shall be paid to the State, Territory or political subdivision thereof, or the District of Columbia, the amount so paid may be deducted by the taxpayer as a necessary expense in transacting business. (Art. 124.)

The above regulation permits the amount paid to the state to be deducted from gross income. However, any profit received by the contractor from a governmental agency is taxable.

REGULATION. Any profit received from the United States, a State or political subdivision thereof by an independent contractor is taxable income. (Art. 22.)

Income of foreign ambassadors and ministers exempt.—

There is no specific provision in the state law similar to that in the federal law⁸⁶ providing for the exemption of income of foreign governments, but the following regulation resembles the federal ruling on this point.⁸⁷

REGULATION. The income of foreign ambassadors and ministers from investments in bonds and stocks and from interest on bank balances, and the fees of foreign consuls-general, consuls, vice-consuls-general, vice-consuls, deputy consuls-general, deputy consuls and consular agents, who are not citizens of the United States, are excluded from gross income, but income of such foreign officials from any business carried on by them in the State of New York would be taxable. The compensation of citizens of the United States who are officers or employees of a foreign government is, however, not exempt from tax. (Art. 77.)

⁸⁴Federal law, section 213 (b-7).

⁸⁶Reg. 45, Art. 84.

⁸⁶Federal law, section 213 (b-5).

⁸⁷Reg. 45, Art. 83.

Alimony or separation allowance not taxable.—

REGULATION. . . . Neither alimony nor an allowance based on a separation agreement is included in gross income, nor are they allowable deductions. (Art. 73.)

Profits from sale of vessels not exempted by state.—Under section 23, paragraph 2, of the Merchant Marine Act, approved June 5, 1920, proceeds of sale of certain vessels are exempt from federal income taxes, but there is no provision exempting the profits on such sales from state income tax.

Income received by officers of religious denominations and by certain institutions exempt.—

LAW. Section 359. The term "gross income":

2. Does not include

g. Income received by any officer of a religious denomination or by any institution, or trust, for moral or mental improvement, religious, bible, tract, charitable, benevolent, fraternal, missionary, hospital, infirmary, educational, scientific, literary, library, patriotic, historical or cemetery purposes, or for the enforcement of laws relating to children or animals, or for two or more of such purposes, if such income be used exclusively for carrying out one or more of such purposes; but nothing herein shall be construed to exempt the fees, stipends, personal earnings or other private income of such officer or trustee.

This section of the state law is analogous to the provisions of the federal law³⁸ exempting "non-profit-making" organizations. The state law, however, is more inclusive, taking in a wider range of quasi-public activities, provided the income is applied to such purposes. It also specifically exempts the income (with the exception stated in the law) of officers of religious denominations, a provision not found in the federal statute.

RULING. In accordance with your oral request I have considered the question:

Just what is excluded from gross income under Tax law Section 359, paragraph 2, subdivision g?

³⁸Federal law, section 231.

This subdivision has seemed ambiguous to a number of people who have raised the question of whether officers of religious denominations were completely exempted by it, whether it applied to officers of institutions and trusts, and whether institutions must be organized for one or more of the purposes mentioned.

It seems to me that all ambiguity disappears if we separate the sentence into its proper clauses, thus:

- (1) "Income received
- (2) by any officer of a religious denomination or by any institution or trust,
- (3) for moral or mental improvement, religious, bible, tract, charitable, benevolent, fraternal, missionary, hospital, infirmary, educational, scientific, literary, library, patriotic, historical or cemetery purposes, or for the enforcement of laws relating to children or animals, or for two or more of such purposes,
- (4) if such income be used exclusively for carrying out one or more of such purposes;
- (5) but nothing herein shall be construed to exempt the fees, stipends, personal earnings or other private income of such officer or trustee."

This means that to be excluded from gross income under this division, the income must (1) have been received (2) by a member of one of three stated classes, (3) for one or more of certain specified purposes, and (4) must actually be used for such purposes.

To make it perfectly clear that the salary of an officer or trustee, given to recompense him for services or to enable him to support himself and family, was not excluded under this subdivision, the last clause was added, eliminating any possible doubt. (Attorney-General's Income Tax Letter No. 5, dated June 6, 1919.)

The distinction made in the last sentence above quoted would seem to be that, if a minister received a sum of money which was to be expended for one of the benevolent purposes mentioned in the law, such sum would be exempt, whereas a fee or salary would be taxable.

Exemption from Personal Property Tax

LAW. Section 352. The taxes imposed by this article are in addition to all other taxes imposed by law, except that money on hand or on deposit with or without interest, bonds, notes and choses in action and shares of stock in corporations other than banks and banking associations owned by any individual or constituting a part of

a trust or estate subject to the income tax imposed by this article,³⁹ shall not after July thirty-first, nineteen hundred and nineteen, be included in the valuation of the personal property included in the assessment-rolls of the several tax districts, villages, school districts and special tax districts of the state.

³⁹[**Former Procedure**] Section 352 at this point read "and from which any income is derived." These words were eliminated in the amendment of 1920.

CHAPTER IV

RETURNS, RATES AND COMPUTATION OF THE TAX

A "return" is a statement of taxable income or of information. Every individual having taxable net income of \$1,000 (unless married and living with husband or wife, when the amount is \$2,000) is required to file an income tax return. In addition to these statements of total net income received, there are various other returns to be made under the income tax law which give to the Comptroller information essential to proper administration.

After the net income subject to tax is ascertained, the total tax payable is determined by a very simple calculation.

In this chapter will be discussed the law and regulations as to who must make returns, the procedure and the time for filing returns and other requirements and the rates and computation of the tax.

Summary of Differences Between State and Federal Procedure

The salient difference in the requirements for filing returns between the federal and state procedure is that the state return need not be filed until one month after the federal return is due. The federal return must be filed on or before the fifteenth day of the third month, and the state return must be filed on or before the fifteenth day of the fourth month following the close of the fiscal year. If returns are made on a calendar year basis the federal return is due March 15 and the state return April 15. (See page 64.)

A reconciliation between the amount of net income reported in the federal return and that shown by the state return is required by the state. There is no similar federal requirement. (See page 90.)

Extensions of time for filing state returns are generally granted by the Comptroller only, rarely by district officers; whereas extensions of time for filing federal returns may under certain conditions be granted by the local collector. (See page 65.)

No specific ruling limiting necessary extensions of time to taxpayers abroad for filing returns has been issued by the state, whereas a federal regulation grants such extension as may be necessary to file federal returns, but not exceeding 90 days after proclamation of peace. (See page 67.)

When a taxpayer desires to file on the basis of a new accounting period, both state and federal procedure require that notice be given 30 days before the due date on the basis of the taxpayer's existing accounting period. It is also required that notice be given at least:

State: 30 days before the close of the proposed taxable year.

Federal: 30 days before the due date of his separate return for the period between the close of the existing taxable year and the date designated as the close of the proposed taxable year. (See page 70.)

The status of a non-resident for state tax purposes is fixed by his status during the last six months of the taxable year. If he qualifies as a non-resident he is required to file a return of income only from sources within the state. A resident, on the other hand, is required to file a return of his income from all sources. Comparison may be made with a non-resident alien who under the federal procedure has his status fixed by his status on the last day of his taxable period. Moreover, under the federal practice a "transient" (alien) who enters the country, intending to make his home elsewhere as soon as he has accumulated sufficient money, is regarded as a non-resident, while the state considers him a resident. (See page 59.)

Special returns showing apportionment of income are required by the state if a partnership or estate or trust carries on a business both within and without the state and has a non-

resident member or beneficiary. No similar federal returns are required. (See Chapters XVI and XVII.)

Corporations are not subject to state income tax (though subject to the state corporation franchise tax), and therefore are not required to file "income tax" returns under the state law, although they must do so under the federal income tax law. (See page 59.)

Personal service corporations under the state law are classed in effect with ordinary corporations and are not required to file "income tax" returns. Under the federal law they are treated as partnerships and must file returns. (See page 63.)

The rates of tax under the state law are: 1 per cent on first \$10,000 of net income after deducting exemptions, 2 per cent on the next \$40,000 and 3 per cent on all over \$50,000. The federal tax consists of a normal tax of 4 per cent on the first \$4,000 and 8 per cent on the balance of the net income, after deducting certain "credits," and also of a so-called surtax of many brackets with rapidly increasing rates. (See page 89.)

In computing the tax for a fiscal year beginning in 1918 and ending in 1919, under state practice, the income for the fiscal year is prorated and the tax is computed on the resulting amount. Under federal practice the tax is computed on the income for the full year at the 1918 and 1919 rates, and the separate taxes so calculated are prorated in the proportion the part of the fiscal year falling in 1918 bears to that in 1919. (See page 91.)

The federal law limits the surtax on profits from sales of oil wells, mines, etc., to 20 per cent of the selling price. (See page 90.)

Who Is Subject to the Tax?

Before proceeding to a consideration of who shall make a return, it is necessary to determine who is subject to the law.

The definition of a taxpayer in the state law is substantially

the same as that in the federal law¹ with the addition of the words "or whose income is in whole or in part subject to a tax imposed by this article and does not include corporations."

LAW. Section 350. . . .

2. The word "taxpayer" includes any person, trust or estate subject to a tax imposed by this article, or whose income is in whole or in part subject to a tax imposed by this article, and does not include corporations. . . .

The definition in the law is amplified in the following:

REGULATION. The word "taxpayer" includes

- (1) Every resident of the State of New York,
- (2) Every estate and trust resident of the State of New York,² whose income is in whole or in part subject to State income tax and
- (3) Individuals and estates and trusts, nonresident of the State of New York,³ receiving taxable income from property owned or from business, trade, profession or occupation carried on or followed within the State of New York. (Art. 3.)

In other words, there are only two classes of taxpayers subject to tax: individuals, and certain estates and trusts. Corporations are not included and make no returns (except information returns) and pay no income tax, although they are subject to a franchise tax. Partnerships, although they pay no tax, must make a return.⁴

Who is a resident?—An avalanche of criticism descended on the framers of the state law for the definition in the law, as originally enacted, which read: ". . . any person who shall, at any time on or after January first and not later than March fifteenth of the next succeeding calendar year, be or become a resident of the state." This subdivision of section 350 was amended (effective May 10, 1920) to read as follows:

LAW. Section 350. . . .

7. The word "**resident**" applies only to natural persons and includes for the purpose of determining liability to the tax imposed by this article upon or with reference to the income of any taxable year,

¹Federal law, section 1.

²See page 80 and Chapter XVII.

³See Chapter XVII.

⁴See page 85.

commencing with the year nineteen hundred and nineteen, any person who shall, at any time during the last six months of the calendar year, be a resident of the state. . . .

The state applies the same test to determine whether or not an individual is a resident as does the federal regulation dealing with non-resident aliens,⁵ which states further that "the best evidence of his intention is afforded by the conduct, acts and declarations of the alien."

The question is of particular interest to business men who maintain living quarters in New York as a matter of business necessity. Their homes are without the state and they are no more actual residents of New York than are transients who live many weeks of each year in New York hotels. In some cases, at least, the so-called New York residence is merely a supplement to the New York office.

REGULATION. For the purpose of the Income Tax Law, a resident of New York State is a natural person, who has a fixed and settled abode in this State to which he returns from incidental and temporary absences and from which he has no present intention of removing. Such residence may not be, nor be intended to be, of long duration if it be fixed and settled and to continue for the time necessary to accomplish some business or other purpose and is not merely transient. A taxpayer's residence for purposes of taxation is not necessarily his domicile for election purposes, as he may be domiciled outside the State and still be taxable as a resident of the State. As the question of residence is largely determined by the intent of the taxpayer and by the facts in each case, the Comptroller may require a statement of the circumstances to aid him in determining whether the individual be a resident or nonresident. (Art. 501.)

The application of the rule "during the last six months of the calendar year" is thus defined by the Attorney-General:

RULINGS. . . . only those persons who were resident in the State between July 1 and December 31 (inclusive) of any year are taxable as residents *for* that year. It should be borne in mind that the tax is collected in the year following the year *for* which it is levied. So a person who resided in New York between July 1 and December 31, 1919, is liable for the 1919 tax even though he left

⁵Reg. 45, Art. 312.

the state between January 1 and March 15, 1920. What I said in Income Tax Letter No. 28, with respect to the difference between the Massachusetts theory and the New York theory, still holds true.⁶

Where a person resided in New York between January 1 and June 30, 1919, or between January 1 and March 15, 1920, but not between July 1 and December 31, 1919, he was taxable as a resident as the law formerly stood, but the retroactive amendment placed him in the class of nonresidents for the taxable year 1919. If any persons so situated have filed returns as residents, they should be permitted to substitute nonresident returns, and in proper cases refunds should be made. (Attorney-General's Income Tax Letter No. 33, dated May 15, 1920.)

. . . . The tax now in process of collection is a tax for 1919, upon the income of 1919; and not a tax for 1920 measured by 1919 income. In Massachusetts the nature of the tax is different—they levy a tax in and for 1920, and measure it by the income of 1919—so it properly is only levied against persons resident in 1920. Our tax is like the property tax in the City of Albany—where the 1919 taxes do not become payable until 1920, but are nevertheless 1919 taxes, assessed on 1919 values and (in case of personalty) 1919 ownership.

Examination of the minutes of the meetings of the joint legislative committee which prepared the income tax law shows that there was some confusion in the minds of those present as to the nature of the tax—whether it was to be on the Massachusetts plan or on the plan eventually adopted. Professor Bullock, the expert from Massachusetts, retained by the committee, seems to have been in favor of the Massachusetts plan, and to have suggested that residence during the first six months of the year be the criterion for taxability of a resident. But the idea of the members of the committee seems to me to have been that the tax for each year (though necessarily payable after its termination) should be based on the income for that year—and the provision defining “resident” as including one moving into the State in the following year was intended as an extension of the ordinary meaning of the word. This is borne out by the fact that as originally introduced the bill provided for the inclusion among residents of persons becoming residents within the first *six months* of the succeeding year. (Senate bill, 1919, int. no. 1198, pr. nos. 1427, 1829.) Later this was amended by substituting the present provision, probably on the theory that the original provision carried the extension too far. . . . (Attorney-General's Income Tax Letter No. 28, dated April 2, 1920.)

Proof of residence.—The following regulation is identical

⁶Quoted below.

with the federal requirement,⁷ except that a transient who enters the state with the intention of making his home elsewhere "as soon as he has accumulated a sum of money sufficient" is *not* to be considered a transient. The federal regulation considers such an individual to be a transient.

REGULATION. An individual's statements as to his intention with regard to residence are not conclusive, but when unequivocal will determine the question of his intention, unless his conduct, acts or other surrounding circumstances contradict the statements. It sometimes occurs that an individual who genuinely intends his stay to be transient may put off his departure from time to time by reason of changed conditions, remaining a transient though living in the State of New York for a considerable time. The fact that an individual's family is without the State does not necessarily indicate that he is a transient rather than a resident. An individual who enters this State intending to make his home elsewhere as soon as he has accumulated a sum of money sufficient to provide for his journey to a point without the State is not to be considered a transient even though his expectation in this regard may reasonably, considering the rate of his saving, be fulfilled within a comparatively short time. (Art. 503.)

Loss of residence.—

REGULATION. It will be presumed that an individual who has established a residence in the State of New York, as outlined above, continues to be a resident until he or his family establish a residence without the State. (Art. 504.)

Having established a residence in the state, it is reasonably provided that mere intent to remove from the state does not make a resident a non-resident. There must be actual removal.

Returns—General

The tax is in the main a self-assessed tax and its success depends largely on the good faith of the persons who are subject to the tax. The making of a return is a moral as well as a legal obligation.

Who shall make returns?—Every person having a net income of \$1,000 must make a return (unless married and liv-

⁷Reg. 45, Art. 313.

ing with husband or wife, when the amount is \$2,000).⁸ Every partnership also must make a return, regardless of the amount of its income, if such income is derived: (1) from property owned within the state of New York, or (2) from a business, trade, profession or occupation carried on in the state of New York.⁹ Partnerships are not themselves taxable upon the net income so reported, but returns must nevertheless be made. Personal service corporations are not required to make income tax returns but they must make returns for the purpose of the New York franchise tax. In this respect the state law differs from the federal law. Under the latter, personal service corporations are treated like partnerships. Corporations are not required by the state law to make returns of income, but are subject to the New York franchise tax.¹⁰

In addition to these statements of total net income received, there are various other returns to be made under the income tax law which give to the Comptroller information considered essential to proper administration. The more important of these are considered later. For information and withholding returns, see Chapters VI and VII.

Comptroller may make or "revise" returns.—In addition to specific provisions for certain returns the law grants to the Comptroller the broad power to revise any return, "if, in the opinion of the Comptroller, any return of a taxpayer is in any essential respect incorrect. . . ." If a taxpayer fails to make a return, "the Comptroller is authorized to make an estimate of the taxable income of such taxpayer."¹¹

Amended returns.—There is no specific reference in the law nor in the regulations to amended returns, except in article 123 which provides for amended returns in the case of

⁸For changes in marital status, see page 35. Fiduciaries must make returns for individuals, trusts or estates for which they act; see chapter XVII. For returns of non-residents, see Chapter XVIII.

⁹Section 368. For details of partnership income, see Chapter XVI.

¹⁰See Part II of this volume.

¹¹Section 373.

losses which were not discovered during the taxable year. It is not necessary that there should be such a reference in order to protect the taxpayer or the state. The power of the Comptroller to require corrected returns is found in section 373 of the law, but he would have such power even if it were not granted in express terms. Obviously the power to require returns and examine the accounts of taxpayers carries with it the power of revision.

On the other hand, the right to correct an erroneous return is inherent in the taxpayer and no express power or permission is required. There are or should be reasonable limitations on the right of taxpayers to submit amended returns, and the Comptroller will no doubt issue regulations thereon in due course. As the Comptroller is restricted to three years after returns are due or made within which to require corrected returns, it is probable that the same limitation will be enforced against taxpayers who wish to take the initiative in rendering amended returns.

The term "amended returns" includes corrections of any kind which may be made without the formality of filling out complete new forms. It is believed that a letter to the Comptroller advising him of a specific mistake, accompanied by a cheque for the additional amount due or by a claim for refund, will serve the purpose and meet the requirements of the Comptroller.

Time for filing returns.¹²—Returns are due three months and fifteen days after the close of the taxable year. This is one month after the date on which federal returns are due.

LAW. Section 371. Returns shall be made to the comptroller on or before the fifteenth day of the fourth month following the close of the fiscal year, or, if the return is made on the basis of the calendar year, then the return shall be made on or before the fifteenth day of April in each year.¹³

¹²For extension of time, see page 65.

¹³[Former Procedure] Returns for 1919 were required by March 15, 1920, in all cases.

Due date.—

REGULATION. The due date is the last day upon which a return is required to be filed in accordance with the provisions of the statute or the last day of the period covered by an extension of time granted by the Comptroller. When the due date falls on Sunday or a legal holiday, the returns will be due the day following such Sunday or legal holiday. (Art. 541.) .

This is practically identical with federal article 447.

If a return is made for a portion of a taxable year the exemptions must be reduced proportionately.¹⁴

Extension of time for filing returns.—

LAW. Section 371. The comptroller may grant a reasonable extension of time for filing returns whenever in his judgment good cause exists and shall keep a record of every such extension and the reason therefor. Except in the case of taxpayers who are abroad, no such extension shall be granted for more than six months.

REGULATION. It is important that the taxpayer render on or before the return due date a return as complete and final as it is possible for him to prepare. However, whenever good cause exists by reason of sickness, absence or otherwise, the Comptroller is authorized to grant an extension of time in which such return may be filed where in his judgment such further time is actually required for the making of an accurate return, but such extension in no case shall exceed six months except in cases of taxpayers who are abroad. If the time for filing the return shall be extended, the taxpayer shall pay, in addition to the tax, interest thereon at the rate of six per centum per annum from the time when the return was originally required to be filed, to the time of actual payment.¹⁵ The application for such extension must be made prior to the due date or before the expiration of the period for which any general or special extension has been granted. As a condition of granting an extension of time for filing a return the Comptroller may require the submission of a tentative return and payment of the tax based on such tentative return. (Art. 543.)

The above article is nearly identical with the federal requirements [section 227 (a) and article 443], excepting that extensions are generally granted by the Comptroller and rarely by the local collection officers, and that the application

¹⁴Section 370; for an exception, see Chapter XVII.

¹⁵Payment of the state tax is made in one sum, whereas the federal tax is payable in four instalments. See page 96.

should be made *before* the expiration of the period in which the filing of the return is normally required. However, if the application is made *after* the due date, the following ruling sets forth the requirements to be met.

RULING. Extensions of time to file returns¹ will be granted by this office only in case of real disability of a taxpayer, such as sickness, death, absence abroad, and in some cases absence from the State and inability to close books.

In all cases, the disability must exist at the time returns are due, or at a time just previous to the due date. The application should be made within a reasonable time after it is determined that the taxpayer will not be able to comply with the law as to filing returns.

All applications filed in district offices should be forwarded to the Albany main office as soon as possible after their receipt, as the date of application is an important factor in deciding as to the advisability of granting such a request.

In acquainting taxpayers as to the conditions under which extensions will be granted, if made after the due date, they should be informed that the applications to this office must be accompanied by an affidavit setting forth clearly and fully the reason for such request and why the application was not made before the last day to file returns.

In the case of disability, affidavits should also contain a statement to the effect that no other person had sufficient knowledge and information of the taxpayer's affairs to make a return for him, or to make application for an extension of time prior to the due date, if made subsequent to the due date.

In the case of the death of the taxpayer, such affidavit should show the date of death, and date of appointment of executor or administrator, if any is appointed. Where the disability is due to sickness, a certificate from the attending physician should accompany the affidavit. Such certificate need not be verified. (Office Memorandum, dated April 29, 1920.)

INTEREST PAYABLE WHEN EXTENSIONS GRANTED.—

LAW. Section 377. . . . If the time for filing the return shall be extended, he shall pay in addition interest thereon at the rate of six per centum per annum from the time when the return was originally required to be filed to the time of payment. . . .

When taxpayers live abroad.—The limitation to six months for extensions contained in the state law¹⁸ is similar to the

¹⁸Section 371.

provision in the federal law¹⁷ in that it does not apply to taxpayers living abroad. The state has not issued any specific ruling as to when returns of taxpayers living abroad must be filed, whereas the federal regulations¹⁸ grant such extension as may be necessary, but not exceeding "90 days after proclamation by the President of the end of the war with Germany." It is presumed that the Comptroller will grant such extensions as the facts may warrant.

Place for filing returns.—The law¹⁹ provides that "returns shall be made to the Comptroller," but the following regulation provides that returns other than information returns (partnership, fiduciary and others) may be made to any district office.

REGULATION. Returns of income must be delivered or mailed to any one of the district offices of the Income Tax Bureau. The following are the addresses of the district offices of the Income Tax Bureau:

- District No. 1. Albany.
- District No. 2. Borough of Manhattan, New York City.
- District No. 3. Borough of Brooklyn, New York City.
- District No. 4. Borough of The Bronx, New York City.
- District No. 5. Jamaica.
- District No. 6. White Plains.
- District No. 7. Buffalo.
- District No. 8. Rochester.
- District No. 9. Syracuse.
- District No. 10. Utica.
- District No. 11. Elmira.
- District No. 12. Binghamton.
- District No. 13. Kingston.

Partnership returns (Form 204) and fiduciary returns (Form 205) should be sent to the office of the New York State Income Tax Bureau at Albany, N. Y. (Art. 544.)

Returns filed by mail.—Returns may be delivered either by hand or by mail.

REGULATION. . . . If placed in the mails the return should be

¹⁷Federal law, section 227 (a).

¹⁸Reg. 45, Arts. 445, 446.

¹⁹Section 371.

posted in ample time to reach the Comptroller's office or any district office of the Income Tax Bureau, under ordinary handling of the mails, on or before the date on which the return is required to be filed. Mailed returns should be addressed "N. Y. State Income Tax Bureau," and the address of the district office to which it is sent. If a return is made and placed in the mails in due course, properly addressed and postage paid, in ample time to reach the office of the Comptroller or a district office on or before the due date, no penalty will attach should the return not be actually received by such officer until subsequent to that date. (Art 541.)

This is practically identical with federal article 447.

Period for which returns are made.—Returns of net income are ordinarily made for the "taxable year."²⁰ Only in unusual circumstances are returns made for a shorter period, as in the cases of changing fiscal years and administrators who have made final accountings of estates.

"TAXABLE YEAR" AND "FISCAL YEAR" DEFINED.—The terms "taxable year" and "fiscal year" are defined in the law as follows:

LAW. Section 350. . . .

4. The words "taxable year" mean the calendar year, or the fiscal year ending during such calendar year, upon the basis of which the net income is computed under this article. The words "fiscal year" mean an accounting period of twelve months, ending on the last day of any month other than December. . . .

This definition is practically identical with that in section 200 of the federal law.

Fiscal year basis available to all taxpayers.—The state law, like the federal law,²¹ extends to taxpayers the privilege of reporting on the basis of a fiscal year.

LAW. Section 358. 1. The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year as the case may be). . . . If the taxpayer's annual accounting period is other than a fiscal year as defined in this article,

²⁰Returns may not be made for a period exceeding 12 months. See page 72.

²¹Federal law, section 212.

or if the taxpayer has no annual accounting period or does not keep books, the net income shall be computed on the basis of the calendar year.

2. If a taxpayer changes his accounting period from fiscal year to calendar year, from calendar year to fiscal year, or from one fiscal year to another, the net income shall, with the approval of the comptroller, be computed on the basis of such new accounting period, subject to the provisions of section three hundred and seventy.²²

Return for fiscal year obligatory if accounts are kept on that basis.—A taxpayer having an existing accounting period which is a fiscal year within the meaning of the statute, is required to make his return on the basis of such a taxable year.²³ This is similar to the federal requirements.²⁴ Thus the state and federal returns will be made for the same period, excepting when the accounting period is changed.²⁵

REGULATION. The return of a taxpayer is made and his income computed for his taxable year, which means his fiscal year, or the calendar year if he has not established a fiscal year. The term "fiscal year" means an accounting period of twelve months ending on the last day of any month other than December. No fiscal year will, however, be recognized unless before its close it was definitely established as an accounting period by the taxpayer and the books of such taxpayer were kept in accordance therewith. The taxable year 1919 is the calendar year 1919 or any fiscal year ending during the calendar year 1919. A taxpayer having an existing accounting period which is a fiscal year within the meaning of the statute not only needs no permission to make his return on the basis of such a taxable year, but is required to do so. A person having no such fiscal year must make return on the basis of the calendar year.

A taxpayer must make his return for the accounting period on the basis of which his books are kept; so that his State return, like his Federal return, must be for a fiscal year if his books are kept on a fiscal year basis.²⁶ (Art. 526.)

RECOGNITION OF A CHANGED ACCOUNTING PERIOD AS A TAXABLE YEAR.—When taxpayers desire to change from one accounting period already established and recognized for tax

²²See page 70.

²³Article 526, below.

²⁴Reg. 45, Art. 25.

²⁵See page 70.

²⁶For computation of tax for fiscal year ended in 1919, see page 91.

purposes to some other period, the Comptroller insists that they give a 30-day written notice and reasons for the intended changes. It is quite proper that changes of this character should be made subject to the approval of the Comptroller, for the taxpayer should not be free to change frequently and arbitrarily from one fiscal year to another.²⁷

Returns when accounting period is changed.—

LAW. Section 370. If a taxpayer, with the approval of the comptroller, changes the basis of computing net income from fiscal year to calendar year, a separate return shall be made for the period between the close of the last fiscal year for which return was made and the following December thirty-first. If the change is made from calendar year to fiscal year, a separate return shall be made for the period between the close of the last calendar year for which return was made and the date designated as the close of the fiscal year. If the change is made from one fiscal year to another fiscal year, a separate return shall be made for the period between the close of the former fiscal year and the date designated as the close of the new fiscal year. If a taxpayer making his first return for income tax keeps his accounts on the basis of a fiscal year, he shall make a separate return for the period between the beginning of a calendar year in which such fiscal year ends and the end of such fiscal year.

In all of the above cases the net income shall be computed on the basis of such period for which separate return is made, and the tax shall be paid thereon at the rate for the calendar year in which such period is included; and the exemptions allowed in this article shall be reduced respectively to amounts which bear the same ratio to the full exemptions provided for as the number of months in such period bears to twelve months.

The exemptions (section 362) which must be prorated are the \$1,000 or \$2,000 and the \$200 allowed for each dependent.

In the case of a taxpayer "making his first return" the provision of the law above quoted, viz., that "he shall make a separate return for the period between the beginning of a calendar year in which such fiscal year ends and the end of such fiscal year," is apt to be confusing. A taxpayer was engaged

²⁷See article 528, page 71.

in business, and had a fiscal year which ended June 30, 1919. In making his first return he reported from January 1, 1919, to June 30, 1919. But if he started in business on July 1, 1919, in making his first return he would expect to report for his fiscal year July 1, 1919, to June 30, 1920. It is a little difficult to interpret the law as quoted above, however, prescribing the period for which the "first return" shall be made, so as to apply it to the case of a taxpayer beginning business and reporting on a fiscal year basis. The clause in the law was framed primarily to take care of the first returns of those already established in business at January 1, 1919, and keeping accounts on a fiscal year basis.

REGULATION. If a taxpayer changes his accounting period he shall as soon as possible give to the Comptroller written notice of such change and his reasons therefor. The Comptroller will not approve a change of the basis of computing net income unless such notice is given at a time which is both (a) at least thirty days before the date of the taxpayer's return on the basis of his existing taxable year and (b) at least thirty days before the close of the proposed taxable year. If the change in the basis of computing the net income of the taxpayer is approved by the Comptroller the taxpayer shall thereafter make his returns upon the basis of the new accounting period in accordance with the requirements of section 370 of the statute and his net income shall be computed as therein provided. A taxpayer subject to Federal tax shall file with his application a copy of the consent of the Commissioner of Internal Revenue to change the basis of his return for Federal tax purposes. The requirement of notice to the Comptroller will be modified in such cases with respect to time, and where a change is authorized, it will be made effective at the same date as that authorized by the Commissioner of Internal Revenue. (Art. 528.)

This regulation is the same as the federal requirement²⁸ excepting clause (b) of the federal regulation, which reads: "at least thirty days before the due date of his separate return for the period between the close of the existing taxable year and the date designated as the close of the proposed taxable year." To illustrate:

Assume a taxpayer reporting on the calendar year basis

²⁸Reg. 45, Art. 26, as amended by T. D. 3032.

(1920) who desires to change to a fiscal year ending October 31. Under the federal regulations notice must be given at least 30 days prior to March 15, 1921, and 30 days prior to January 15, 1921. Under the state regulations notice must be given at least 30 days prior to April 15, 1921, and 30 days prior to October 31, 1920.

The phrase "due date" has been construed under the federal regulations to mean the original due date of the return and not the date on which the return should be filed in case of an extension of time. It would probably be so construed by the state.

Return must not cover period exceeding twelve months.—

REGULATION. No return may be made for a period of more than twelve months. . . . (Art. 529.)

Blank forms for returns.—

LAW. Section 371. . . . Such returns shall, so far as may be, set forth the same or similar items called for in the blank forms of return prescribed by the United States commissioner of internal revenue for the enforcement of the act of congress known as the revenue act of nineteen hundred and eighteen, together with such other facts as the comptroller may deem necessary for the proper enforcement of this article

The forms issued by the state follow in the main the federal forms. The state form calls for a reconciliation between the income reported to the federal government and that reported to the state.

LAW. Section 371. . . . Blank forms of return shall be furnished by the comptroller upon application, but failure to secure the form shall not relieve any taxpayer from the obligation of making any return herein required.

REGULATION. Copies of the prescribed return forms will so far as possible be furnished taxpayers by the Comptroller. Failure on the part of any taxpayer to receive a blank form will not, however, excuse him from making a return. Taxpayers not supplied with the proper forms shall make application therefor to the Comptroller, or at any district office, in ample time to have their returns prepared, verified and filed on or before the due date. Each taxpayer should carefully prepare his return so as to fully and clearly set forth the

data therein called for. Imperfect or incorrect returns will not be accepted as meeting the requirements of the statute. In lack of a prescribed form a statement made by a taxpayer disclosing his gross income and deductions therefrom may be accepted as a tentative return, and if filed within the prescribed time a return so made will relieve the taxpayer from liability to penalties, provided that without unnecessary delay such a tentative return is replaced by a return made on the proper form. The forms and the instructions contained therein have the force and effect of regulations. Each question must be answered and each direction complied with in the same manner as if the forms and instructions were embodied in these regulations. (Art. 531.)

Two forms for different classes of individual income—for residents.—

REGULATION. The return shall be on Form 201 unless the taxpayer's entire gross income is derived from personal services, interest and dividends or from partnerships, estates and trusts. The return shall be on Form 200 if the taxpayer's gross income is derived from personal services, interest and dividends or from partnerships, estates and trusts, but any taxpayer may make a return of his income on Form 201. Forms are provided by the Comptroller and may be had at any office of the State Comptroller. When by reason of illness, absence, minority, nonresidence or otherwise the person liable for the return is unable to make it, the return may be made by an agent, guardian, or other person charged with the care of the person or property of such taxpayer, the agent assuming the responsibility for making the return and incurring liability to the specific penalties provided for erroneous, false or fraudulent returns. Art. 522.)

Annual Return by Individuals

LAW. Section 367. Every taxpayer²⁹ having a net income for the taxable year of one thousand dollars or over if single or if married and not living with husband or wife, or of two thousand dollars or over if married and living with husband or wife, shall make under oath a return stating specifically the items of his gross income and the deductions and credits allowed by this article. . . .³⁰

REGULATION. . . . Whether or not an individual is the head of a family or has dependents is immaterial in determining his liability to render a return. If an individual is a married person living with

²⁹"Taxpayer" is defined by sections 350, 1, to include "any person, trust or estate subject to a tax imposed by this article, and does not include corporations."

³⁰See page 75.

husband or wife, no return need be made where their aggregate net income is less than \$2,000; but a separate return must be made by each of them, regardless of the amount of the individual income of each, where their aggregate net income is \$2,000 or over, unless they join in a single return. The husband shall include in his return the income derived from services rendered by the wife or from the sale of products of her labor if she does not file a separate return or join with him in a return setting forth her income separately. . . . (Art. 521.)

The law calls for a return based on "net income." In arriving at net income for the sole purpose of determining whether or not to make a return, the exemptions, such as those for single and married persons and for dependents, are not deducted. Likewise dividends are not deducted. If the net income as thus computed is \$1,000 or over if single or \$2,000 or over if married, a return must be made even though the exemptions mentioned above reduce the taxable income so that no tax is payable.

Liberty bond interest and other exempt income are not taxable by the state and should be disregarded in determining whether or not to make a return.

The only person whose income exceeds \$1,000 but is less than \$2,000 who may refrain from reporting is one who is "married and living with husband or wife." Heads of families who are unmarried must report when they have income in excess of \$1,000, even though because of dependents they may have "exemptions" enough to cancel all their income above that amount.

On the other hand: "When specifically directed by the Comptroller an individual must file the return of his income whether or not such income is subject to taxation under this law." (Art. 521.)

When return must be filed by agent.—

LAW. Section 367. . . . If the taxpayer is unable to make his own return the return shall be made by a duly authorized agent or by the guardian or other person charged with the care of the person or property of such taxpayer. . . .

An agent uses the form which his principal would file if able to do so.

Returns must be under oath.—The law requires that "Every taxpayer . . . shall make under oath a return."³¹ It is also provided:

LAW. Section 371. . . . There shall be annexed to such return the affidavit or affirmation of the person making the return, to the effect that the statements contained therein are true. . . .

Section 373-a. The director of the income tax bureau, and each assistant, deputy and district director, and each cashier, senior auditor, auditor and junior auditor, of the income tax bureau, shall have the power to administer an oath to any person, or to take the acknowledgment of any person, in respect of any income tax report or return required by or pursuant to this article, or the rules and regulations of the comptroller.

REGULATION. All income tax returns must be verified under oath or affirmation before an officer duly authorized to administer oaths either by the laws of the United States or the laws of the state or territory where such officer resides. Persons in the naval or military service of the United States may verify their returns before any official authorized to administer oaths for the purpose of those services. Income tax returns executed abroad may be attested before United States consular officers. (Art. 530.)

Separate returns of husband and wife—when desirable.—

LAW. Section 367. . . . If a husband and wife living together have an aggregate net income of two thousand dollars or over, each shall make such a return unless the income of each is included in a single joint return. . . .

If, in case of husband and wife, each receives an independent income equal to or in excess of \$1,000, separate returns may be made, but a joint return will ordinarily serve unless the combined net income exceeds \$10,000. Below that the taxes would be the same even though the incomes were merged.

When the net income shown in a single return exceeds \$10,000, an increased rate (2 per cent instead of 1 per cent) begins to apply. By rendering separate returns the applica-

³¹Section 367.

tion of the increased rates is deferred to the extent of an additional \$10,000.

The following instructions appear on form 201 (individual return—page 1 of instructions):

5. *When husband and wife should file separate returns:*

(a) If not living together each should file separate returns as single persons, regardless of the fact that each may be the head of a separate family as defined under Instruction D.

(b) If living together, and each or both have *separate* incomes of \$10,000 or more.

The requirement (b) was not inserted to preclude the filing of a joint return by husband and wife, even if their aggregated separate incomes exceed \$10,000, but to give the taxpayer the opportunity of taking advantage of the lower taxes which result from separate returns in most cases.

If a husband has losses which exceed his income and if his wife has a net taxable income, the filing of a joint return will permit the husband's losses to be offset against his wife's income and vice versa. The following federal ruling is of interest in this connection:

RULING. Receipt is acknowledged of your letter of January 17th, 1921, in which you state that during the year 1920 your income was approximately \$54,000. During the same period your wife suffered a net loss of \$62,000. You request to be advised whether under the circumstances you and your wife may file a joint return for the purpose of applying your wife's net losses against your income. You are advised that there is no provision of the law by which a husband and wife can be denied the privilege of filing a joint return. Your wife's net losses may therefore be deducted from your income in determining income subject to both the normal tax and the surtax where you and your wife elect to file a joint return. (Letter authorized for publication, signed by Commissioner Wm. M. Williams, and dated February 3, 1921.)

It is understood that the state will follow the principles set forth above and will permit the filing of joint or separate returns at the discretion of the taxpayer. Obviously when both have taxable incomes, separate returns will be filed; and when one has a loss, joint returns will be filed. There can be

no objection to taking advantage of this privilege, but the author is of the opinion that it does not accord with the intention of the law nor with the principles which underlie an individual tax law. The basis of the family unit, if extended any further or if the foregoing ruling is carried to its logical conclusion, will result in far greater taxation than will result if the principle of individual returns is adhered to.

Returns by minors.—The state procedure in the case of minors closely follows the federal.

REGULATION. An individual under twenty-one years of age is required to render a return of income if he has a net income of his own of \$1,000 or over for the taxable year. If he is married, see article 521. If the aggregate of the net income of a minor from any property which he possesses, and from any funds held in trust for him by a trustee or guardian, and from any earnings for his own use, is at least \$1,000, a return as in the case of any other individual must be made by him or by his guardian or some other person charged with the care of his person or property for him. If, however, a minor is dependent upon his parent, who appropriates or may appropriate his earnings, such earnings are income of the parent and not of the minor for the purpose of the tax. In the absence of proof to the contrary a parent will be assumed not to have emancipated his minor child and must include in his return any earnings of the minor. Nonresident minors must make return in the same manner and of the same classes of income as other nonresidents. The provisions of article 523 are equally applicable to nonresident minors.⁸² (Art. 524.)

The assumption that a parent has not emancipated his minor child is reasonable; otherwise minor children with taxable incomes might erroneously assume that they were not individually responsible for making returns, and the parent in turn might assume that, as a minor child had a taxable income, the latter was responsible for the making of returns. But the earnings of the minor must be from personal services in order to be taxable to the parent. The income of a minor from his or her separate property is not to be included in the income of the parent.

⁸²See Chapter XVIII.

RULING. 1. Where the personal earnings of the minor are actually appropriated by the parent, they are to be included in the return of the parent. The infant need make no return in respect of such earnings.

2. Where a minor is not regularly employed, and his earnings are those received for services rendered during vacation periods or the like, such earnings are income to the parent and not of the minor for the purpose of the tax, and if retained by the minor are to be considered as a gift from parent to minor.

3. Where a minor is married, he is required to make a return and pay a tax the same as any adult individual. In such a case the parent is not required to include the minor's earnings in his return as he cannot appropriate them.

4. Where a minor is regularly employed, and has an income sufficient to be self-supporting, a separate return must be made if he has a net income of \$1,000 or more, if single, or \$2,000 or more if married and living with wife. In such a case the parent is not required to include the minor's salary in his own return; nor is he entitled to an exemption, even if the minor is under eighteen. (Official ruling, dated January, 1920.)

Returns by soldiers and sailors.—If income consists solely of compensation from the United States government no return is required, because such income is not taxable.³³ Under the federal law such income in excess of \$3,500 is taxable.

Return by Fiduciaries

The duties of fiduciaries are fully explained in Chapter XVII. The state law follows the federal law in classifying fiduciaries as individuals so far as returns are concerned. Annual returns are required by law, as follows:

LAW. Section 369. Every fiduciary (except receivers appointed by authority of law in possession of part only of the property of a taxpayer) shall make under oath a return for the individual or estate or trust for whom he acts, as follows:

WHEN RETURN IS MADE FOR AN INDIVIDUAL.—

1. If he acts for an individual whose entire income from whatever source derived is in his charge and the net income of such individual is one thousand dollars or over if single, or if married and

³³Section 359, 2, f.

not living with husband or wife, or two thousand dollars or over if married and living with husband or wife.

RETURN FOR ESTATE DURING PERIOD OF ADMINISTRATION.—

2. If he acts (a) for an estate of a deceased person during the period of administration or settlement, whether or not the income of such estate during such period of administration or settlement is properly paid or credited to any legatee, heir or other beneficiary;

RETURN FOR ESTATE WHOSE INCOME IS NOT DISTRIBUTED.—

(b) for an estate or trust the income of which is accumulated in trust for the benefit of unborn or unascertained persons, or persons with contingent interests; or (c) for an estate or trust the income of which is held for future distribution under the terms of the will or trust;

NO RETURN NECESSARY UNLESS INCOME AMOUNTS TO \$1,000 OR MORE.—

and the net income of such estate or trust is one thousand dollars or over.

The foregoing classification, as well as that given below, follows that laid down in section 365³⁴ of the law, which provides the manner in which the tax shall apply to estates and trusts or "any kind of property held in trust." The cases specified above are those in which the fiduciary pays the tax; in the cases specified below the fiduciary does not pay the tax. This is similar to the classification in the federal law. The state law, however, is more specific in regard to requirements for returns.

RETURN FOR ESTATE WHEN INCOME IS DISTRIBUTED PERIODICALLY.—

LAW. Section 369.

3. If he acts (a) for an estate or trust the income of which is to be distributed to the beneficiaries periodically; or

RETURN AS GUARDIAN OF INFANT.—

(b) as the guardian of an infant whose income is to be held or

³⁴See Chapter XVII.

distributed as the court may direct; and any beneficiary of such estate or trust receives or is entitled to a distributive share of the income of the estate or trust of one thousand dollars or more.

REQUIREMENTS FOR FIDUCIARY RETURNS.—The following sections of the state law are practically identical with the federal law (section 225).

LAW. Section 369. . . .

3. . . . The return made by a fiduciary shall state specifically the items of the gross income and the deductions, exemptions and credits allowed by this article. Under such regulations as the comptroller may prescribe, a return made by one of³⁵ two or more joint fiduciaries shall be a sufficient compliance with the above requirement. The fiduciary shall make oath that he has sufficient knowledge of the affairs of the individual, estate or trust for whom or which he acts to enable him to make the return, and that the same is, to the best of his knowledge and belief, true and correct.

Fiduciaries required to make returns under this article shall be subject to all the provisions of this article which apply to taxpayers.

Summary of fiduciary returns.—There has been confusion in regard to fiduciary returns because in some cases the tax is based on these returns and is paid by the fiduciary, while in other cases the fiduciary returns, although calling for detailed statement of the various kinds of income, are used simply to check the amounts reported by the beneficiaries or distributees, who must pay the tax on their distributive shares.

REGULATION. Every fiduciary or at least one of joint fiduciaries (except receivers appointed by authority of law, in possession of part only of the property of the taxpayer) is required to make a return of income for the individual or trust or estate for whom he acts (either (1) as a tax return or (2) as an information return) as follows:

1. Tax Returns—

The fiduciary of every trust or estate must make a return, on Form 200 or 201, and of every nonresident trust or estate on Form 203 for nonresident trusts and estates, and pay the tax on the taxable income of each trust or estate taxed as an entity having a net income of \$1,000 or over during the taxable year in the case of:

- (a) Income received by estates of deceased persons during the period of administration or settlement;

³⁵Law reads "or."

- (b) Income accumulated in trust for the benefit of unborn or unascertained persons or persons with contingent interests;
- (c) Income held for future distribution under the terms of a will or trust.

In (a) the fiduciary is entitled to deduct the amount of income properly paid or credited to any beneficiary.

The fiduciary of an estate or trust is entitled to the personal exemption of \$1,000 in ascertaining the tax liability of the estate or trust.

In the absence of any specific allocation of income under the will or deed or trust, every distribution shall be deemed to apply ratably to taxable and nontaxable income of the estate or trust.

2. Information Returns—

The fiduciary of every estate or trust (resident or non-resident) must make an information return on Form 205 if any beneficiary receives or is entitled to a distributive share of taxable income of \$1,000 or over during the taxable year in the following cases:

- (a) Income which is to be distributed to beneficiaries periodically, whether or not at stated intervals;
- (b) Income collected by the guardian of an infant, to be held or distributed as the court may direct;
- (c) Income of the estate of any deceased person, which during the period of administration or settlement, is properly paid or credited to any legatee, heir or other beneficiary.

In the absence of any specific allocation of income, under the will of deed or trust, every distribution shall be deemed to apply ratably to taxable and nontaxable income of the estate or trust and the beneficiary must be guided by the same allocation.

No tax is to be paid by the fiduciaries on these returns as the income is taxable to the beneficiaries, but there shall be included in computing the net income of each beneficiary his distributive share, whether distributed or not, of the net income of the estate or trust for the taxable year.

If the estate or trust (a) has a nonresident beneficiary and (b) carries on business (as "business carried on" is defined in article 415) both within and without the State of New York, the fiduciary shall accompany his return with a schedule of apportionment on Form 205 A. (Art. 246.)

ALLOCATION OF TAXABLE AND NON-TAXABLE INCOME UPON DISTRIBUTION.—It will be noted in the foregoing ruling that the following language is used in two places:

In the absence of any specific allocation of income under the will or deed of trust, every distribution shall be deemed to apply ratably to taxable and non-taxable income of the estate or trust.

To illustrate: A trust has income of \$12,000, consisting of \$10,000 taxable and \$2,000 non-taxable bond interest. A distribution of 30 per cent, or \$3,600, is made to a beneficiary. This amount might be allocated so as to consist of the entire non-taxable income of the trust, i.e., \$2,000, the balance, \$1,600, to be taxable income. Under the method prescribed by the state, however, unless the will or deed of trust contained a specific provision, the \$3,600 distributed would be deemed to apply ratably, viz., non-taxable (30 per cent of \$2,000) \$600 and taxable (30 per cent of \$10,000) \$3,000.

The requirement is a reasonable one.

Responsibility of fiduciary to make returns.³⁶—

LAW. Section 365.

2. The fiduciary shall be responsible for making the return of income for the estate or trust for which he acts, whether such income be taxable to the estate or trust or to the beneficiaries thereof.

BENEFICIARY'S SHARE TO BE STATED.—

. . . . and in cases under paragraphs d and e of subdivision one³⁷ of this section, the fiduciary shall include in the return a statement of each beneficiary's distributive share of such net income, whether or not distributed before the close of the taxable year for which the return is made.

This section is similar to the federal requirement.

RETURN WHERE BENEFICIARY'S INCOME IS IN CHARGE OF FIDUCIARY.—

REGULATION. Every fiduciary must make a return of income for every individual whose entire income is in charge of such fiduciary, if the net income of such individual is \$2,000 or over, if living with husband or wife, or \$1,000 or over in other cases. If such individual is a resident, the return shall be made on Form 200 or 201, and if he

³⁶For definition of "fiduciary," see Chapter XVII.

³⁷When income is distributed, see Chapter XVII,

is a nonresident, the return shall be made on Form 203. In such cases, the fiduciary must pay the tax shown by the return to be due. (Art. 247.)

When the income of an estate is from a business carried on both within and without the state and there is a non-resident beneficiary, form 205A must be filed. This is to apportion the income to the non-resident beneficiary as to sources within and without New York.

FIDUCIARY MUST FILE RETURN FOR DECEDENT.—Not only must a fiduciary file a return for the estate for which he acts, but he must also file a personal return for the decedent. The requirements of the state are identical with the federal, excepting that the following regulation states that the executor “may” file a return for the decedent “without waiting for the close of the taxable year.”

REGULATION. As soon as possible after his appointment and qualification, without waiting for the close of the taxable year, an executor or administrator may file a return of income for the decedent. Upon the completion of the administration of an estate and final accounting an executor or administrator shall file a return of income of the estate for the portion of the taxable year in which the administration was closed. An ancillary administrator need make no separate return if the domiciliary administrator includes in his return the entire income of the estate. Similarly, upon the termination of any other trust the trustee may make a return without waiting for the close of the taxable year. In any such case the tax must be paid at the time the return is filed. The payment of the tax before the end of the taxable year in such circumstances does not relieve the taxpayer from liability for any additional tax which may subsequently be imposed upon income of the taxable year. (Art. 542.)

If a return is made for part of a year the personal exemptions must be reduced proportionately,³⁸ but an exception is made in the case of a return for a decedent and the return on termination of period of administration. In such case the full personal exemptions are allowed.³⁹

³⁸Section 370.

³⁹Article 209; see Chapter XVII.

The following ruling illustrates the procedure indicated above.

RULING. Answering your inquiry of recent date relative to the filing of a return for a decedent by his administrator or executor:

1. If the decedent's taxable year was a calendar year and his net income from January 1st to the date of his death within that year is \$1,000 or over if unmarried, or \$2,000 or over, if married, a return must be made by the executor or administrator and such executor or administrator may claim all deductions and exemptions to which the decedent would have been entitled under the law.

2. If the decedent's taxable year was a fiscal year and his net income from the end of the previous taxable year ending within the calendar year to the date of his death is \$1,000 or over if unmarried, or \$2,000 or over if married, a return for such decedent must be made by the executor or administrator and such executor or administrator may claim all deductions and exemptions to which the decedent would have been entitled under the law.

3. In the case of a man dying in January or February or prior to [April] 15th before he has filed his annual return then due the executor or administrator is required to make his return and pay the tax.

4. If an individual dies during a taxable year his executor or administrator in making a return for him is entitled to claim his full personal exemption, according to the status of the decedent. (Official ruling, dated November 8, 1919.)

RETURNS WHEN THERE ARE TWO TRUSTS.—

REGULATION. In the case of two or more trusts the income of which is taxable to the beneficiaries, which were created by the same person and are in charge of the same trustee, the trustee may at his option make a single return on Form 205 for all such trusts, notwithstanding that they may arise from different instruments. When, however, a trustee holds trusts created by different persons for the benefit of the same beneficiary he shall make a return on Form 205 for each trust separately. (Art. 249.)

RETURN BY RECEIVER.—

REGULATION. A receiver who stands in the stead of an individual must render a return of income on Form 200 or 201 and pay the tax for his trust, but a receiver of only part of the property of an individual need not do so. A receiver in charge of the business of a partnership shall render a return on Form 204. A receiver appointed to hold and operate a mortgaged parcel of real estate, to whom rents and profits are paid, but who is not in con-

trol of all the property or business of the mortgagor, and a receiver in partition proceedings, are not required to render returns of income. In general statutory receivers and common law receivers of all the property or business of an individual must make returns. (Art. 250.)

RETURN BY GUARDIAN OR BY COMMITTEE FOR AN INCOMPETENT.—

REGULATION. A fiduciary acting as the guardian of a minor or as the committee of an incompetent person must make a return of income for such person, whose entire income is in charge of such fiduciary, if the net income of such person is \$2,000 or over if living with husband or wife, or \$1,000 or over in other cases. If such person is a resident the return shall be made on Form 200 or 201, and if a nonresident, the return shall be made on Form 203. In such cases the fiduciary must pay the tax as shown by the return to be due. (Art. 248.)

Annual Returns by Partnerships

The state law is similar to the federal law⁴⁰ in that partnerships pay no taxes as entities, but the partners are individually taxable for their distributive shares. Every partnership, however, must file an annual return giving the data necessary for the determination of the distributive shares. Personal service corporations under the state law, unlike the federal law, are *not* identified with partnerships⁴¹ and are not required to file returns, nor are their stockholders subject to personal income tax on profits of such corporations, unless distributed.

Partnership returns.—

LAW. Section 368. Every partnership shall make a return for each taxable year, stating specifically the items of its gross income and the deductions allowed by this article, and shall include in the return the names and addresses of the individuals who would be entitled to share in the net income if distributed and the amount of the distributive share of each individual. The return shall be sworn to by any one of the partners.

⁴⁰Section 368 of the state law quoted above is identical with section 224 of the federal law.

⁴¹Section 350, 2.

REGULATION. Every partnership deriving income (a) from property owned within the State of New York, or (b) from a business, trade, profession or occupation carried on within the State of New York must make a return of income, regardless of the amount of its gross or net income and regardless of the residence of the partners. The return shall be on Form 204 and shall be sworn to by one of the partners. If the partnership (a) has a nonresident member, and (b) carries on business (as "business carried on" is defined in article 415) both within and without the State of New York, its return shall be accompanied by a schedule of apportionment on Form 204-A. Such return shall be made for the fiscal year of the partnership, that is, for its annual accounting period (fiscal year or calendar year as the case may be), irrespective of the taxable years of the partners. If the partnership makes any change in its accounting period, it shall make its return in accordance with the provisions of the Tax Law, section 370, article 529. (Art. 230.)

A requirement in the state regulations⁴² that is different from federal procedure is the apportionment required by form 204-A mentioned above. This is necessary to determine the amount of income to be allocated to a non-resident partner, when there is such and when the partnership business is carried on both within and without the state.

The information demanded in a partnership return (when all the partners are residents) is similar to that required in the federal return, excepting that in the state return the amounts of dividends and interest on obligations of the United States received by the partnership are not needed for the purpose of "credits" in the personal returns of the partners, as is the case under the federal law, which permits "crediting" such items for the purpose of the normal tax. The federal law⁴³ also permits a "credit" against the tax on each partner's proportionate share of any income or profits tax paid by the partnership to a foreign country. There is no similar credit for residents allowed by the state, but a non-resident partner may receive credit for his proportionate share of taxes paid to the state or country in which he resides on income arising from sources within New York State.

⁴²Article 457, see Chapter XVI.

⁴³Federal law, section 222 (4).

REGULATION. The return of a partnership shall state specifically (a) the items of its gross income enumerated in section 359 of the Tax Law; (b) the deductions enumerated in section 360 other than the deductions provided in paragraph 10 of that section; (c) the names and addresses of the individuals who would be entitled to share in the net income of the partnership if distributed; (d) the amount of the distributive share of such net income of each such individual; and (e) such other facts as are required by Form 204. (Art. 231.)

Changes in partnership during taxable year.—There are many changes in partnership relations which do not involve dissolution of existing partnership. When changes occur during a fiscal year, because of the death or withdrawal of a partner or the admission of a new partner, and when the partnership continues with the exception of the changes mentioned, no good purpose would seem to be served by making returns until the end of the taxable year.

REGULATION. Whenever a new partner is received into a partnership, or any existing partnership is reorganized, the facts as to such change or reorganization should be fully set forth in the next return of income in order that the Comptroller may determine whether any gain or loss has been realized by any partner. (Art. 101.)

The foregoing regulation is identical with the federal requirements.⁴⁴ The reference to the "next return" would not indicate that an immediate or special return was required. Every partnership return is merely an "information" return and is useful only after the returns on which it is a check have been filed.

Return by receiver of partnership.—Article 250 of the Comptroller's regulations provides that "a receiver in charge of the business of a partnership shall render a return on form 204." This also would be in the nature of a return of information and would not be a return on which the tax would be directly assessed. The federal procedure is similar.⁴⁵ The

⁴⁴Reg. 45, Art. 1570.

⁴⁵Reg. 45, Art. 424.

return would indicate the distributive profits or losses of the partners during the period covered by the receivership. When a receiver is appointed for a partnership the same person is usually made receiver for each of the partners.

Income from partnerships included in individual returns of partners.—The requirements under the state law are identical with those of the federal law⁴⁶ in that the individual returns of partners for 1920 must include the entire distributive shares credited to such partners "for any accounting period of the partnership ending within the fiscal or calendar year upon the basis of which the partner's net income is computed."

If it is more convenient for a partner to make a return for a year ending at some date other than December 31, he may do so. However, if a partner continues to report personally for the calendar year, he must include in his return the share of his profits credited to him by the partnership on December 31, 1920, or on the last day of the month in 1920 which marked the close of the partnership's fiscal year.⁴⁷

Returns of "information at source" and "payment at source."—The subjects of withholding and information at the source are treated fully in later chapters, and reference should be made thereto for the returns required.

Payments for personal service and of interest on registered bonds or other obligations exceeding in total \$1,000 are reported to the Comptroller annually on or before April 15 on form 105—made out for each individual—accompanied by the annual summary and letter of transmittal, form 106.⁴⁸ No return is required when there has been actual withholding, as that is reported on forms 102 and 103.⁴⁹

Withholding agents will file with the Comptroller an-

⁴⁶Federal law, section 218 (a).

⁴⁷For non-residents, see Chapters XVI and XVIII.

⁴⁸Articles 282 and 287.

⁴⁹Article 283.

nually on or before April 15, forms 102 revised and 103, showing the amounts of tax withheld, accompanied by payment of such tax.⁵⁰

Returns of dividends paid to resident stockholders may be required by the Comptroller.⁵¹

Rates

The state law imposes one form of tax with only three gradations, whereas the federal tax consists of a normal or flat tax, and a so-called surtax of many brackets, each bracket with a different rate.

After the net income has been ascertained, the personal exemptions are deducted, and on the balance the tax is: 1 per cent on the first \$10,000, 2 per cent on the next \$40,000, and 3 per cent on amounts over \$50,000.

There are no "credits" against net income, as under the federal law, for dividends; nor is there any credit against the tax, after it is computed, for taxes paid at source on tax-free covenant bond interest, nor for income and profits taxes paid during the taxable period to foreign countries or possessions of the United States.

There is a credit for income taxes paid by non-residents to the states or countries in which they reside.⁵²

LAW. Section 351. A tax is hereby imposed upon every resident of the state, which tax shall be levied, collected and paid annually upon and with respect to his entire net income as herein defined at rates as follows: One per centum of the amount of net income not exceeding ten thousand dollars; two per centum of the amount of net income in excess of ten thousand dollars but not in excess of fifty thousand dollars; three per centum of the amount of net income in excess of fifty thousand dollars. . . . Such tax shall first be levied, collected and paid in the year nineteen hundred and twenty upon and with respect to the taxable income for the calendar year nineteen hundred and nineteen, or for any taxable year ending during the year nineteen hundred and nineteen.

⁵⁰Article 267.

⁵¹Article 288.

⁵²See Chapters XIII and XVIII.

Surtax on sale of mineral deposits.—There is no provision in the state law similar to that in the federal law⁵³ to the effect that the surtax attributable to a "sale of mines, oil or gas wells, or any interest therein, where the principal value of the property has been demonstrated by prospecting or exploration and discovery work done by the taxpayer" shall not exceed 20 per cent of the selling price.

Computation of the Tax

While there is no necessity to compute surtax, as there is under the federal law, the necessity for apportionment of income to sources within and without the state and the use of various factors in determining such apportionment have complicated the procedure under the state law as compared with the federal. The federal law does not call for detailed computations such as are required by forms 204-A and 205-A, of partnerships doing business within and without the state, having non-resident partners and of fiduciaries of estates having non-resident beneficiaries.

Illustrations of computation of the tax will be found in Appendix A.

Reconciliation of returns and books of account.—Provision is made on the return forms⁵⁴ for a reconciliation of the net income reported to the state with that reported in the federal return. A reconciliation should be kept between the net profit shown by the books and the net income reported to the federal government. In this way any item reported in the state return can be traced to the books.

It is known that the state is making thorough verifications of returns, and an explanation will be required of any material differences between amounts reported in the federal and state returns.⁵⁵

⁵³Section 211.

⁵⁴Long form 201, item 13, page 1 (individuals); form 204, item 7, page 1 (partnerships); form 205, item 7, page 1 (fiduciaries).

⁵⁵For illustration of reconciliation on state return, see Appendix A.

Individual fiscal years—personal credits to be reduced for fractions of year.—The state procedure is similar to the federal in that when an individual changes from a calendar year to other fiscal year, or vice versa, he must report for a fractional part of a year.⁵⁶ In such cases both state and federal⁵⁷ procedure requires reduction of the personal exemptions.

Fiscal year ending in 1919.—

REGULATION. The method provided for computing the tax for a fiscal year beginning in 1918 and ending in 1919 is as follows: The tax attributable to the calendar year 1919 is found by computing the income of the taxpayer in accordance with the statute for the fiscal year and determining the proportion of such income which the portion of such fiscal year falling within the calendar year is of the full fiscal year, and computing the tax on such amount. The personal exemption must be correspondingly apportioned. (Art. 527.)

The state practice is different from that under the federal law.⁵⁸ Under the latter the tax is computed at the 1918 and 1919 rates, respectively, for the full year, and then is prorated. Under the state regulations, the *income* for the full fiscal year is prorated first and then the tax is computed on the resulting amount.

The prorating of the income prescribed by article 527, noted above, may not be equitable in case of a seasonal business in which most of the profits were earned in the part of the fiscal year falling in 1918. If the books show income accrued to January 1, 1919, only the income accrued after that date should be reported, as the law⁵⁹ is based on "the method of accounting regularly employed in keeping the books of such taxpayer."

⁵⁶See page 70.

⁵⁷Federal law, section 226.

⁵⁸Federal law, section 205 (b).

⁵⁹Section 358, i.

CHAPTER V

ADMINISTRATION

Administration and enforcement of the law are delegated to the state Comptroller, who is authorized to divide the state into districts and maintain branch offices therein.¹ He is granted powers to revise incorrect returns, to examine books and records of taxpayers, to take testimony, to grant extensions of time for filing returns, and, in case returns have not been filed by taxpayers, to estimate their taxable income. The Comptroller is also authorized to make rules and regulations and to collect information necessary to enforce the provisions of the law.²

As the laws assign to the Comptroller duties in addition to the administration of the income tax law, he has created a division within his office known as the Income Tax Bureau, for the purpose of carrying out the duties which this law imposes upon him. The main office of this bureau is at Albany. As the bureau is created by the Comptroller and not by statute, it can only act in his behalf, and therefore references in this chapter are generally made to the Comptroller.

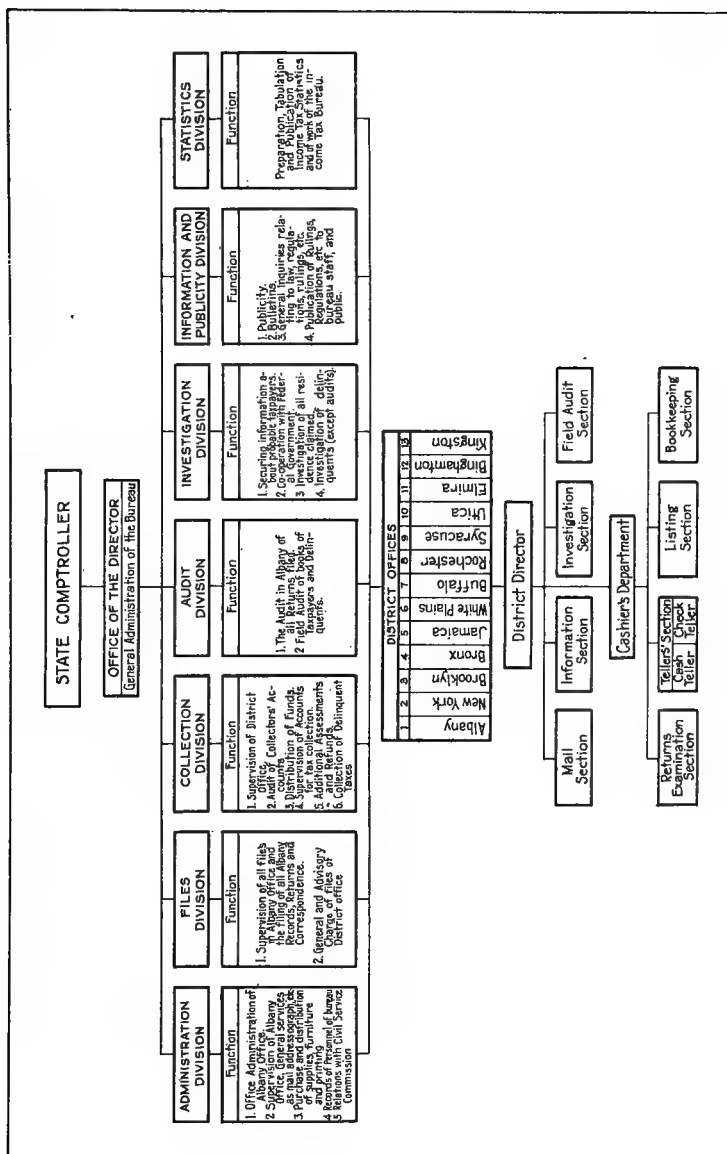
Organization

Organization of Income Tax Bureau.—The chart appearing on the opposite page indicates the organization of the Income Tax Bureau which the Comptroller has created. The bureau is divided into seven sections. The functions of each division are enumerated in the chart. The taxpayer will come in contact most frequently with the Collection, Audit, Investigation, Information and Publicity divisions.

Administration of the income tax law is centralized in the

¹Section 372.

²Section 383.



Income Tax Bureau. Although the law provides for the creation of district offices, the state Comptroller, while establishing these offices, very properly has not materially decentralized the organization of the Income Tax Bureau and each branch office receives its powers from the Albany office and is subject to control by that office at all times. Decentralization of income tax administration is not feasible under present conditions.

BRANCH OFFICES.—The law authorizes the Comptroller to create branch offices.

LAW. Section 372. The comptroller shall administer and enforce the tax herein imposed for which purpose he may divide the state into districts in each of which a branch office of the comptroller may be maintained; provided that in no cases shall a county be divided in forming a district.

Pursuant to the foregoing the Comptroller has divided the state into thirteen districts and has established offices in the following places:

District Office	Location	Director
1. Albany office	42 No. Pearl St.	Roy H. Palmer
2. New York	120 Broadway (Equitable Bldg.)	Niles R. Becker
3. Brooklyn	317 Washington St.	Henry B. Cocheu
4. The Bronx	St. Ann's Ave & 161st St.	Thomas W. Whittle
5. Jamaica	2 No. Washington St.	George U. Harvey
6. White Plains	Court House	Courtney D. Whittemore
7. Buffalo	11-13 W. Swan St.	Henry Seilheimer
8. Rochester	106-108 Main St., E. (United Bldg.)	James M. Mangan
9. Syracuse	423½ Salina St.	A. A. Kocher
10. Utica	110 Genesee St. (City Nat. Bk. Bldg.)	Fred J. Graff
11. Elmira	230 Lake St.	Louis C. Andrews
12. Binghamton	Court & State Sts.	Henry B. Mulford
13. Kingston	518 Broadway	J. DePuy Hasbrouck

Organization of branch offices and duties of the directors.—At the bottom of the chart is an outline of the organization of each of the district offices. As there shown each district office is placed in charge of a district director who has general supervisory powers over each of the units making up the organization. These units consist of four general sec-

tions and what is called the "cashier's department." The latter itself is made up of four separate sections. Directors of the branch offices have only the powers which the director at Albany has conferred upon them. Generally speaking, it can be said that the district offices perform three functions, namely :

1. They collect the tax.
2. They execute the field audit of such returns as may be referred to them by the Albany office.
3. They carry on investigational work authorized by the director at Albany.

Branch offices are not authorized to audit any returns³ except by instruction of the Comptroller. The district directors have been authorized by the Comptroller to grant extensions of time for filing returns not to exceed fifteen days from April 15. However, as a general rule, applications for extensions of time are forwarded to the main office at Albany, as it is necessary to keep in that office a record of all extensions; and it is only when such a reference is inexpedient that the district directors exercise their authority to grant extensions. When an extension of time is granted by a district office, all the correspondence and a copy of the written permission go immediately to Albany to be inserted in the taxpayer's file folder.

CERTAIN ALBANY OFFICERS SPEND PART TIME IN THE BRANCH OFFICE IN CITY OF NEW YORK.—Because of the large number of taxpayers living in the city of New York, the director of the Income Tax Bureau, the chief of the Audit Division and the chief of the Investigation Division spend two days each week in the New York office at 120 Broadway. The chief of the Investigation Division devotes his time and attention to the work of his division. The chief of the Audit Division and the director spend their time in hearing in-

³See page 102.

formal appeals by taxpayers against whom additional assessments have been made, who have applied for revision and readjustment under section 374, or are protesting the additional assessment without such formal application.

Assessment and Payment

Like the federal law, the New York law virtually imposes upon taxpayers the duty of "self-assessment."

LAW. Section 377. 1. Each taxpayer shall, or in cases where an agent or a guardian or other fiduciary makes return for the taxpayer on whose behalf he is acting, then the agent, guardian or other fiduciary shall, at the time of filing his return, pay to the comptroller the amount of tax payable hereunder as the same shall appear from the face of the return. . . .

Unlike the federal law, however, there is no provision for payment in four instalments. The entire tax must be paid on the date (on or before April 15) when the return is filed.

Method of assessment when no return is filed.—

LAW. Section 373. . . . if any taxpayer fails to make return as herein required, the comptroller is authorized to make an estimate of the taxable income of such taxpayer from any information in his possession, and to audit and state an account according to such . . . estimate so made by him for the taxes, penalties and interest due the state from such taxpayer. . . .

If a demand for payment based on such a compilation were made, no matter how erroneous it might be, payment would have to be made and any overpayment would have to be secured by refund.

It might be possible, however, to compromise the penalties.⁴

Place of payment.—The return may be filed and payment made at any one of the thirteen branch offices,⁵ or the return may be mailed with payment direct to the Comptroller at Albany.

⁴See page 114.

⁵See page 94.

Payment may be made by uncertified chèques.—

REGULATION. The Comptroller will accept uncertified checks in payment of income taxes, provided such checks are collectible at par, that is, for their full amount without any deduction for exchange or other charges. The day on which the Comptroller receives the check will be considered the date of payment so far as the taxpayer is concerned unless the check is returned dishonored. If one check is remitted to cover two or more persons' taxes, the remittance must be accompanied by a letter of transmittal stating (a) the name of the drawer of the check; (b) the amount of the check; (c) the amount of any cash, money order or other instrument included in the same remittance; (d) the name of each person whose tax is to be paid by the remittance; and (e) the amount of the payment on account of each person. (Art. 554.)

The foregoing is practically the same as article 1733 of Regulations 45 of the Treasury. But under the federal law, if a collector wishes to demand payment by certified cheque he may do so, as the federal article reads: "Collectors *may* accept uncertified checks."

PROCEDURE IN CASE OF DISHONORED CHEQUES.—

REGULATION. If any check is returned unpaid, all expenses incident to collection of such a check will be charged to the taxpayer. If any taxpayer whose check has been returned uncollected by the depository bank should fail at once to make the check good, the Comptroller will proceed to collect the tax as though no check had been given. A taxpayer who tenders a certified check in payment for taxes is also not released from his obligation until the check has been paid. (Art. 555.)

Receipt is issued when payment is made in cash.—

REGULATION. The Comptroller will issue a cash register receipt for every tax which is paid in cash. In the case of payments in cash, the taxpayer should in every instance require a cash register receipt. In the case of payments made by check, the cancelled check is usually a sufficient receipt, but the Comptroller will on request issue an additional receipt. (Art. 552.)

Taxpayers should preserve all receipts and canceled cheques,^a because, as in federal procedure, these must be presented with any claim for refund which may be filed. Some

^aSee above.

question might arise also as to whether payment had been made.

Payment on leaving the country.—

RULING. In reply to your letter of January 8, you are advised that there is no provision of the Personal Income-Tax Law which requires a taxpayer to obtain a certificate from the State showing that he has complied with all the regulations regarding the income tax, before being permitted to leave the country.

The Federal government has such a requirement and if you will communicate with the Collector of Internal Revenue [of your district], the necessary information will be given you. (Official ruling, dated January 12, 1920.)

The New York law has no provision similar to section 252 (g)⁷ of the federal law, which permits the Commissioner under certain conditions to declare the taxable period terminated and demand immediate payment of all taxes. Generally speaking, a state has no power to prevent its residents from going into another state or abroad. This makes it all the more difficult to administer a state income tax law.

Collection of taxes by warrant.—

LAW. Section 380. If any tax imposed by this article or any portion of such tax be not paid within sixty days after the same becomes due, the comptroller shall issue a warrant under his hand and official seal directed to the sheriff of any county of the state commanding him to levy upon and sell the real and personal property of the person owning the same, found within his county, for the payment of the amount thereof, with the added penalties, interest and the cost of executing the warrant, and to return such warrant to the comptroller and pay to him the money collected by virtue thereof by a time to be therein specified, not less than sixty days from the date of the warrant. . . .

It should be noted that the above warrant may be issued without giving any notice to the taxpayer.

The nature of this warrant is very similar to that of the distraint warrant which is issued under the federal law. Immediately upon its issuance the officer to whom it is issued

⁷See *Income Tax Procedure*, 1921, page 174.

seizes and sells sufficient property to satisfy the tax which is due.

WARRANT BECOMES A LIEN WHEN PROPERLY RECORDED.—

LAW. Section 380. . . . The sheriff shall within five days after the receipt of the warrant, file with the clerk of his county a copy thereof, and thereupon the clerk shall enter in the judgment docket, in the column for judgment debtors, the name of the taxpayer mentioned in the warrant, and in appropriate columns the amount of the tax or portion thereof and penalties for which the warrant is issued and the date when such copy is filed, and thereupon the amount of such warrant so docketed shall become a lien upon the title to and interest in real property or chattels real of the person against whom it is issued in the same manner as a judgment duly docketed in the office of such clerk. The said sheriff shall thereupon proceed upon the same in all respects with like effect, and in the same manner prescribed by law in respect to executions issued against property upon judgments of a court of record, and shall be entitled to the same fees for his services in executing the warrant to be collected in the same manner.

WARRANT MAY BE ISSUED ALSO TO CERTAIN AGENTS.—

In the discretion of the comptroller, a warrant of like terms, force and effect may be issued and directed to any agent authorized to collect income taxes, and in the execution thereof such agent shall have all the powers conferred by law upon sheriffs, but shall be entitled to no fee or compensation in excess of actual expenses paid in the performance of such duty. If a warrant be returned not satisfied in full, the comptroller shall have the same remedies to enforce the claim for taxes against the taxpayer as if the people of the state had recovered judgment against the taxpayer for the amount of the tax.

COLLECTION CANNOT BE MADE BY WARRANT AFTER THREE YEARS.—If a taxpayer has filed a return, the Comptroller cannot collect by warrant after the expiration of three years.

LAW. Section 373. (1) . . . Except in the case of a wilfully false or a fraudulent return with intent to evade the tax, the amount of tax due under any return shall be determined by the comptroller within three years after the return was due or was made. . . .

The federal law provides for assessment within "five years after the date when the return was due or was made."⁸

⁸*Income Tax Procedure*, 1921, page 170.

Tax declared a debt.—

LAW. Section 351-b. Every tax imposed by this article and all increases, interest and penalties thereon, in addition to being a tax against property, business, trade, profession or occupation, as in this article provided, shall also become, from the time it is due and payable, a personal debt, from the person or persons liable to pay the same, to the state of New York.

The foregoing section was added among the 1920 amendments.

Suit for collection may be brought at any time.—

LAW. Section 381. Action may be brought at any time by the attorney-general of the state at the instance of the comptroller, in the name of the state to recover the amount of any taxes, penalties and interest due under this article.

In view of section 373, which states that "the amount of tax due under any return shall be determined by the Comptroller within three years after the return was due or was made," a question arises as to whether or not this section applies only: (1) when a false or fraudulent return has been filed, which is excepted by section 373, or (2) when no return has been filed. The Comptroller is given the sole power to examine and audit returns for the purpose of determining additional taxes. It would seem to follow, therefore, that suit may be brought "at any time" only in the above two cases.

Of course, if the Comptroller makes the necessary examination within the three-year period, suit may be brought at any time under the foregoing section.

Examination of Returns

The return filed by the taxpayer is subsequently subjected to an audit to determine whether or not the taxpayer has computed his tax in accordance with the law.

LAW. Section 373. (1) If in the opinion of the comptroller, any return of a taxpayer is in any essential respect incorrect, he shall have power to revise such return. . . .

Comptroller's power to examine records of taxpayer.—The Comptroller has practically the same power as that which the Commissioner of Internal Revenue has under the federal law to examine records of the taxpayer.

LAW. Section 373. . . .

2. The comptroller, for the purpose of ascertaining the correctness of any return or for the purpose of making an estimate of taxable income of any person where information has been obtained, shall also have power to examine or to cause to have examined, by any agent or representative designated by him for that purpose, any books, papers, records or memoranda bearing upon the matters required to be included in the return, and may require the attendance of the person rendering the return or any officer or employee of such person, or the attendance of any other person having knowledge in the premises, and may take testimony and require proof material for his information, with power to administer oaths to such person or persons.

Examination must be made within three years in certain cases.—Paragraph (2) of section 377 provides that "as soon as practicable after the return is filed, the Comptroller shall examine it and compute the tax." A conflict apparently exists between this section and the following:

LAW. Section 373. (1) . . . Except in the case of a wilfully false or a fraudulent return with intent to evade the tax, the amount of tax due under any return shall be determined by the comptroller within three years after the return was due or was made.

NO LIMITATION IN CASE OF FALSE OR FRAUDULENT RETURN.—

In the case of such wilfully false or fraudulent returns the amount of tax due may be determined at any time after the return is filed and the tax may be collected at any time after it becomes due. . . .

Examination and audit of returns.—All returns are audited in the Albany office. This is desirable because it tends to produce uniformity. If a return cannot be audited without additional information, the taxpayer is requested by letter to furnish such information as is necessary. Taxpayers should always comply fully with requests for data required for the

audit of their returns. Failure to furnish the necessary information may cause the Comptroller to make an arbitrary assessment, which he is authorized to do, and thereby force the taxpayer to file claim for refund if the assessment or any part thereof is erroneous.

If the information necessary to the audit of a return cannot be obtained by correspondence, a field audit is made through one of the branch offices.

Taxpayers should be notified in advance of proposed assessment.—The author is of the opinion that the state Comptroller should issue a letter, similar to the federal A-2 letter,⁹ before the issuance of assessment for additional taxes. This letter would place the taxpayer on notice that he was to receive an additional assessment and it would also set forth the reasons for it.

Many assessments are made without any correspondence with the taxpayer, and it is quite possible that the Comptroller may not have considered very pertinent facts which the taxpayer would have furnished willingly. The receipt of such a letter would enable a taxpayer fully to explain the matter to the Comptroller before assessment was made.

As interest runs from the date when the tax was originally due at the rate of 1 per cent a month, the state Comptroller would not lose anything by this procedure.

Taxpayer is notified of the result of the examination.—In case an additional amount is found due, the Comptroller requires the taxpayer to pay that amount with interest.

LAW. Section 377. . . .

3. If the amount of tax as computed shall be greater than the amount theretofore paid, the excess shall be paid by the taxpayer to the comptroller within ten days after the amount of the tax as computed shall be mailed by the comptroller. . . .

This section is, in effect, the same as the federal law which

⁹See *Income Tax Procedure*, 1921, page 172.

requires payment within "ten days after notice and demand by the collector."¹⁰ It is important to note, however, that interest runs at the rate of 1 per cent a month "from the date the tax was originally due to the date of payment."¹¹ In the case of the federal law, interest does not begin to run until after notice and demand for payment has been made.¹²

In case, however, the examination shows that the taxpayer has overpaid his tax, the Comptroller is authorized to make a refund.

LAW. Section 377. . . .

4. If the amount of tax as computed shall be less than the amount theretofore paid, the excess shall be refunded by the comptroller out of the proceeds of the tax retained by him as provided in this article.

This section differs from the federal law in that the taxpayer does not have to file a claim for refund, but the Comptroller makes the refund of his own volition.

The law does not state, however, that the refund shall be with interest.

Abatement or Application for Revision

If every taxpayer thoroughly understood the personal income tax law and its application and always assessed himself and paid the correct amount of tax, there would, of course, be no such things as abatement and refunds in the sense used here. But because of the many erroneous computations it is important that taxpayers should know what procedure to follow when seeking to have an additional assessment abated or an overpayment refunded.

After the Comptroller has made an examination of the taxpayer's return and has notified him that an additional amount of tax is due, the taxpayer may either pay the tax and ask for a refund, or he may request the Comptroller to hold the

¹⁰Revenue Act of 1918, section 250 (e).

¹¹Section 377; see page 113 for further discussion.

¹²*Income Tax Procedure*, 1921, page 181.

assessment in abeyance until he shall have submitted evidence as to why the tax should not be collected.

Is Comptroller's regulation warranted by law?—Unlike the federal law, the New York law does not specifically provide for a claim for abatement as such.

REGULATION. Where the Comptroller has made an additional assessment, the amount of such additional assessment is payable within ten days from the date of notice thereof. However, the taxpayer will be afforded opportunity to offer proof as to the incorrectness of all or any part of the additional assessment and may during the ten-day period file claim for abatement of all or any part thereof. The application must be sustained by the affidavit of the party against whom the tax was assessed, or of other parties cognizant of the facts. When a tax has been audited and stated by the Comptroller the presumption is that the assessment is correct, and the additional assessment must be paid when due, unless the Comptroller has in the meantime abated all or a part of it. The burden of proof in rebutting the presumption and showing that it was improperly or illegally assessed, or that relief should be given under section 374 of the statute, rests upon the applicant for abatement. The affidavits must, therefore, contain full and explicit statements of all the material facts relating to the claim in support of which they are offered and to the proper consideration of which they are essential. The legality of the claim is to be determined by the Comptroller upon the facts presented by the affidavits. The filing of a claim for abatement does not operate as a suspension of the collection of the tax. The tax must be paid within the ten-day period, except as to any part thereof which the Comptroller has advised the taxpayer has been abated. (Art. 573.)

The above article was evidently modeled after article 1032 of the federal regulations, but there is no provision in the state law similar to that in the federal law upon which the federal regulation was based.

No form for a claim for abatement has been issued by the state Comptroller.

Application for revision of additional assessment.—Section 374 provides for procedure whereby a demand for an additional tax may be held in abeyance. This section reads as follows:

LAW. Section 374. If an application for revision be filed with the comptroller by a taxpayer within one year from the time of the filing of the return, or if the tax of such taxpayer shall have been recomputed, then from the time of such recomputation, the comptroller shall grant a hearing thereon and if it shall be made to appear, upon any such hearing by evidence submitted to him or otherwise, that any such computation includes taxes or other charges which could not have been lawfully demanded, or that payment has been illegally made or exacted of any such amount so computed, the comptroller shall resettle the same according to law and the facts, and adjust the computation of taxes accordingly, and shall send notice of his determination thereon to the taxpayer.

It is not clear whether or not the foregoing applies only to those cases in which the tax has been paid and a refund thereof is sought. It is understood, however, that the Comptroller has interpreted this section to cover the following cases: (1) when an assessment has been made, but a tax has not been paid; and (2) when an overpayment of tax has been made.

This section of the law does not specifically mention a claim for abatement; but the benefits of such a claim (under the Comptroller's liberal interpretation of section 374) may be obtained by following the procedure outlined in the succeeding paragraphs.

After a taxpayer receives a notice from the Comptroller that he is liable for an additional amount of tax and that it must be paid within ten days from the date of the notice, if he desires to contest the validity of the assessment, he must file with the state Comptroller within the 10-day period an application for a revision.

The Comptroller has not yet issued a form for such application, but any form supported by the proper affidavits, stating that the taxpayer desires a revision of the Comptroller's computation, because it is not in accordance with the law and the regulations, will be sufficient.

The affidavit should contain a full and explicit statement of all material facts. It should also contain complete references to the law and the regulations bearing on the matters

in dispute and should cite such authorities, precedents and business practices as are applicable.

If the taxpayer for any reason does not wish to file an elaborate statement, he may file an application for revision, stating in general the reasons why the Comptroller's computation should not be used as the basis for an assessment, and requesting that he be granted a hearing. The author believes that the Comptroller will grant such applications when filed in good faith. The data outlined in the preceding paragraph will have to be submitted in writing in advance or on the day of the hearing.

After the application is considered the amount of the assessment may be abated in part or in full. That part which is not abated must be paid upon the demand of the Comptroller. Interest will be added to the amount of the additional assessment at the rate of 1 per cent a month, dating from the day when the tax was originally due.¹³

Where application may be filed.—The application for revision may be filed at any of the branch offices or at the main office at Albany. As the branch offices merely forward the applications to Albany, it would appear that as a general rule it would be advisable for taxpayers to send their applications direct to Albany.

Refunds

After a tax has been paid and the taxpayer believes that it was unlawfully or wrongfully assessed or collected, he may make claim for refund, on form 110. Generally speaking, the state imposes few restrictions upon claims for refund and such claims are considered on their merits. This practice must not be confused with the procedure in case of suit against the government. When suit is brought the government interposes all the legal obstacles at its command.

The Comptroller has shown a commendable spirit in mak-

¹³See page 113.

ing refunds promptly. The federal government does not make them promptly.

Claims for refund may be filed within one year.—The provisions for a claim for a refund for taxes erroneously paid are found in section 374 (see page 105).

The author is of the opinion that the one-year provision contained in this section does not apply to taxes illegally collected.

Procedure in claim for refunds.—The following article sets forth in detail the procedure which should be followed in claims for refund.

REGULATION. Claims by the taxpayer for the refunding of taxes and penalties erroneously or illegally collected shall be made on Form 110.¹⁴ In this case, as in that of claims for abatement, the burden of proof rests upon the claimant. All the facts relied upon in support of the claim should be clearly set forth under oath. It should be accompanied by the Comptroller's receipt or the cancelled check showing payment of the tax. The affidavit may be made by an agent of the person assessed. Checks in payment of claims allowed will be drawn in the names of the persons entitled to the money and shall unless otherwise directed be sent by the Comptroller directly to the proper persons or their duly authorized attorneys or agents. In the case of mere overpayments by taxpayers the Comptroller may repay the excess. The Comptroller has no authority to refund on equitable grounds penalties legally collected. (Art. 574.)

It will be noted that the claim for refund should be accompanied by the collector's receipt or by the canceled cheque showing payment of the tax.

If claim for abatement was not made, the claim for refund should be supported by satisfactory evidence, as described above. If claim for abatement was made and denied it cannot be expected that the claim for refund will be allowed, but the taxpayer has nothing to lose by attempting to improve his case and by securing any new evidence which will strengthen it.

¹⁴For copy of form 110, see Appendix A.

Application to review Comptroller's determination must be made within 30 days.—The following section of the law sets forth the procedure which must be followed in order to review the Comptroller's determination of an application for revision or for a claim for refund.

LAW. Section 375. The determination of the comptroller upon any application made to him by any taxpayer for revision and re-settlement of any computation of tax, as prescribed by this article, may be reviewed in the manner prescribed by and subject to the provisions of section one hundred and ninety-nine of this chapter. No certiorari to review any statement of a computation or any determination by the comptroller under this article shall be granted unless notice of application therefor is made within thirty days after the service of the notice of such determination. Eight days' notice shall be given to the comptroller of the application for such writ. Before making the application an undertaking must be filed with him, in such amount and with such sureties as a justice of the supreme court shall approve, to the effect that if such writ is dismissed or the determination of the comptroller affirmed, the applicant for the writ will pay all costs and charges which may accrue against him in the prosecution of the writ, including costs of all appeals.

Section 374 does not require the Comptroller to hear an application for revision or a claim for refund within any specified time. As the relief granted by the above section is dependent upon the Comptroller's decision, the taxpayer may experience some difficulty in securing relief under the law as it now stands for taxes erroneously or illegally collected.

The law should place some limitation as to time on the Comptroller. If he refused to grant a hearing and make a determination within six months, as under federal procedure, the courts would probably permit the taxpayer to bring an action against the Comptroller.

Payment under protest.—It is not necessary that payment be made under protest in order to sustain a claim for refund; but when the taxpayer intends to bring an action at law,¹⁵ if the Comptroller denies the claim for refund, it is advisable to pay the tax under protest. The following form may be used:

¹⁵See above.

I hereby protest against the assessment of the tax levied against me as evidenced in notice dated.....on the ground that it is erroneous and illegal, and payment is hereby made solely to prevent the imposition of penalties threatened and the attachment of my property.

Power to restrain collection of tax.—In view of the specific remedy for review by writ of certiorari and in view of the decision in the federal¹⁶ and state courts holding that taxpayers have an adequate remedy at law when an illegal tax is assessed, it is not likely that a state court would enjoin the Comptroller from collecting a tax, the assessment of which has been made final.¹⁷

The author is of the opinion, however, that what might have been an adequate remedy at law in the decided cases may not be so in income taxes, illegally assessed, and that in due course the precedents upon which reliance is now placed will be modified or reversed.

Penalties

Generally speaking, penalties may be divided into the following classes:

1. Penalties for failure to file returns and to pay tax.
2. Penalties for understatement of tax.
3. Penalties for failure to withhold and pay tax.

Each of the above classifications of penalties may be subdivided into: (a) interest, or ad valorem; (b) specific penalties.

(a) An interest, or ad valorem, penalty is a certain percentage of the tax which the law provides shall be added to the original tax for some omission on the part of the taxpayer or a withholding agent. The amount is added to the tax and is collected by demand from the Comptroller.

(b) A specific penalty is a fixed amount of a fine and

¹⁶*Snyder v. Marks*, 109 U. S. 189; quoted in *Income Tax Procedure*, 1921, page 208.

¹⁷*United Lines Telegraph Co. v. Grant, Sheriff*, 137 N. Y. 7.

imprisonment to which the taxpayer or withholding agent may be subjected for failure to perform his duties under the law. Such penalties may be imposed only after the offender shall have been tried and convicted. They are imposed by the courts and cannot be collected by assessment, as the Comptroller collects in the case of interest penalties.

Practically all the following penalties were inserted by the 1920 amendments. Any acts committed prior to May 10, 1920 (the date of the amendments), would be covered by the old sections of the law.¹⁸

Penalties for failure to file and pay tax.—Excepting in the case of information returns,¹⁹ the tax is payable at the time when the return is filed. It is possible, however, that a taxpayer might file a return and for various reasons not pay the tax. This procedure of itself would not reduce the penalties, because the same penalties apply to both acts.

However, the taxpayer's reason for not filing a return or for not paying the tax and his subsequent conduct have a considerable effect on the amount of the penalty to which he becomes liable.

If a taxpayer after realizing that he has omitted to file a return and pay the tax due at the proper time, of his own free will and without any outside stimulus, takes steps to rectify his omission by filing a return or paying the tax as the case may be, he should be treated more leniently than the taxpayer whose omission is discovered by the state investigators or who is forced to pay the tax by court action. These two classes—voluntary and involuntary—are treated separately in the discussion which follows.

Taxpayer who acts voluntarily.—

LAW. Section 376. 1. **If any taxpayer, without intent to evade any tax imposed by this article, shall fail to make a return of income or pay any tax if one is due at the time required by or under the**

¹⁸See page 110 *et seq.*

¹⁹For penalties for failure to file information returns, see page 116.

provisions of this article, but shall voluntarily make a correct return of income and pay the tax due within sixty days thereafter, there shall be added to the tax an additional amount equal to five per centum thereof, but such additional amount shall in no case be less than two dollars, and an additional one per centum for each month or fraction of a month during which the tax remains unpaid. . . .²⁰

If the taxpayer files his return of his own free will within 60 days of the date when it was due, he is subject to an ad valorem penalty of 5 per cent, together with interest at 1 per cent per month from the date when the tax was originally due.

However, if he does not file the return within 60 days of the original due date, he will be liable to an ad valorem penalty of 100 per cent and to interest at the rate of 1 per cent per month on the doubled tax from the original due date.

LAW. Section 376. . . .

2. If any taxpayer fails voluntarily to make a return of income or to pay a tax if one is due within sixty days of the time required by or under the provisions of this article, the tax shall be doubled and such doubled tax shall be increased by one per centum for each month or fraction of a month from the time the tax was originally due to the date of payment. . . .

The foregoing, paragraph (2), fails to differentiate between taxpayers who voluntarily file returns after 60 days have elapsed since the returns were due, and those who are for one reason or another compelled to file returns. If in the latter case there is shown to be no intention to evade the tax, the statutory penalties are the same as those imposed against the taxpayers who have voluntarily filed returns. It can be assumed that the Comptroller in the exercise of his discretion will deal differently with the two classes. Under federal prac-

²⁰[Former Procedure] Prior to amendment this paragraph read:

"2. If any such person shall fail or refuse to make a return of income at the time or times hereinbefore specified, but shall voluntarily make a correct return of income within sixty days thereafter, there shall be added to his tax five per centum of the amount otherwise due, but such additional amount shall in no case be less than two dollars.

"3. If any person liable to taxation under this article fails to make a return as herein required, the amount of income of such person discovered to be taxable shall be subject to twice the ordinary rate of taxation."

tice statutory penalties which may be remitted are not enforced when delinquent returns are voluntarily filed. Similarly under state procedure delinquent taxpayers who voluntarily file returns may reasonably expect to have imposed upon them the minimum penalties. Taxpayers who are delinquent, and who remain delinquent unless and until the Comptroller discovers their delinquency, may expect the maximum penalties.

The statutory penalties are severe, but it must be remembered that the Comptroller has the power to reduce the interest and ad valorem penalties if good cause be shown. It is understood that good reasons for the omission to file returns or to pay the tax when due will be sympathetically considered by the Comptroller and any unnecessary hardship mitigated as far as the case may warrant.

SPECIFIC PENALTY.—In addition to the above ad valorem and interest penalties, a delinquent taxpayer, even if he subsequently files a return of his own free will, will be subject to a *specific* penalty not exceeding \$1,000.

LAW. Section 376. . . .

3. **Any individual, corporation or partnership, who, without fraudulent intent, shall fail to pay, or to deduct or withhold and pay any tax, or to make, render, sign or verify any return, or to supply any information, within the time required by or under the provisions of this article, shall be liable to a penalty of not more than one thousand dollars, to be recovered by the attorney-general in the name of the people by action in any court of competent jurisdiction.²¹ . . .**

This penalty can be recovered only by a court action, but can be compromised by the Attorney-General with the consent of the Comptroller.

²¹[Former Procedure] Prior to amendment this paragraph read:

"1. Any person required by this article to make, render, sign or verify any return, who fails to make, render, sign or verify such return within the time required by or under a provision of law, or who makes any false or fraudulent return or statement, with intent to evade any tax imposed by this article, shall be guilty of a misdemeanor and shall, upon conviction, be fined not to exceed one thousand dollars, or be imprisoned not to exceed one year, or both, at the discretion of the court."

Taxpayer who files involuntarily.—Any taxpayer who files a return or pays the tax only as a result of state investigation or of court action does so involuntarily, and for that reason is subject to the 100 per cent and interest penalty provided in section 376 (2) above. In addition he will be liable to the specific penalty under section 376 (3).

Omission to file returns “with intent to evade any tax.”—

LAW. Section 376. . . .

4. **Any individual**, corporation or partnership, or any officer or employee of any corporation, or member or employee of any partnership, **who, with intent to evade any tax** or any requirement of this article or any lawful requirement of the comptroller thereunder, **shall fail to pay the tax**, or to make, render, sign or verify any return, or to supply any information, **within the time required** by or under the provisions of this article, **or who, with like intent, shall make, render, sign or verify any false or fraudulent return or statement, or shall supply any false or fraudulent information, shall be liable to a penalty of not more than one thousand dollars**, to be recovered by the attorney-general, in the name of the people, by action in any court of competent jurisdiction, **and shall also be guilty of a misdemeanor and shall, upon conviction, be fined not to exceed one thousand dollars or be imprisoned not to exceed one year, or both, at the discretion of the court.** ²²

In addition to the specific penalty, a taxpayer who has failed to perform the acts referred to above, or who has rendered a false or fraudulent return with the intention of evading the tax, is also subject to the 100 per cent and interest penalty provided for in section 376 (2).

Understatement of tax.—Interest penalties for understatement of tax are divided into three classes:

1. When the return is made in good faith.
2. When the understatement is due to negligence but without intent to defraud.
3. When the understatement is false or fraudulent with intent to evade.

²²[Former Procedure]. Part of this paragraph was included in the old paragraph (1) quoted in footnote 19.

These three paragraphs of section 377, relating to interest penalties which apply to understatement of tax, were added by the 1920 amendments and became effective May 10, 1920.

Unlike the federal law, the interest dates from the date when the tax was originally due.

LAW. Section 377. . . .

3. . . . The interest provided for in this subdivision shall in all cases be computed from the date the tax was originally due to the date of payment. . . .

INTEREST OR AD VALOREM PENALTIES.—

. . . . In such case, if the return is made in good faith and the understatement of the amount in the return is not due to any fault of the taxpayer, there shall be no penalty or additional tax because of such understatement, but interest shall be added to the amount of the deficiency at the rate of one per centum for each month or fraction of a month. . . .

If the understatement was due to negligence, but without intent to defraud, the following section applies:

LAW. Section 377. . . .

3. . . . If the understatement is due to negligence on the part of the taxpayer but without intent to defraud, there shall be added to the amount of the deficiency five per centum thereof, and in addition, interest at the rate of one per centum per month for each month or fraction of a month.

The following paragraph covers cases of fraud:

LAW. Section 377. . . .

3. . . . If the understatement is false or fraudulent with intent to evade the tax, the tax on the additional income discovered to be taxable shall be doubled and an additional one per centum shall be added to the amount so due for each month or fraction of a month.

The Comptroller is authorized to reduce or compromise any of the penalties provided by the three foregoing paragraphs.²³

SPECIFIC PENALTIES.—

LAW. Section 376. . . .

3. Any individual, corporation or partnership, who, without fraud-

²³See page 118.

ulent intent, shall fail to pay, or to deduct or withhold and pay any tax, or to make, render, sign or verify any return, or to supply any information, **within the time required** by or under the provisions of this article, **shall be liable to a penalty of not more than one thousand dollars**, to be recovered by the attorney-general in the name of the people by action in any court of competent jurisdiction. . . .

The foregoing paragraph covers cases in which there is no fraudulent intent, but the following one takes care of cases in which fraud is involved.

LAW. Section 376. . . .

4. **Any individual**, corporation or partnership, or any officer or employee of any corporation, or member or employee of any partnership, **who, with intent to evade any tax** or any requirement of this article or any lawful requirement of the comptroller thereunder, **shall fail to pay the tax**, or to make, render, sign or verify any return or to supply any information, within the time required by or under the provisions of this article, **or who, with like intent, shall make**, render, sign or verify **any false or fraudulent return** or statement, or shall supply any false or fraudulent information, **shall be liable to a penalty of not more than one thousand dollars**, to be recovered by the attorney-general, in the name of the people, by action in any court of competent jurisdiction, **and shall also be guilty of a misdemeanor** and shall, upon conviction, **be fined not to exceed one thousand dollars** or be imprisoned **not to exceed one year, or both**, at the discretion of the court. . . .

The Attorney-General is authorized to compromise the penalties set forth in paragraphs (3) and (4) above.

Failure to file information returns and withholding returns and to pay the tax withheld.—The withholding and information requirements of the law apply to the following:

1. Individuals.
2. Corporations.
3. Partnerships.
4. Lessees or mortgagors.
5. Fiduciaries.
6. Employers.
7. Officers and employees of the state.
8. Officers and employees of any municipal corporation.

Therefore, if any of the foregoing fail to file the required returns and pay the tax, they are subject to the following penalties:

INTEREST, OR AD VALOREM, PENALTIES.—

LAW. Section 376. 1. . . . If any withholding agent, without intent to evade any tax imposed by this article, shall fail to make a return and pay a tax withheld by him at the time required by or under the provisions of this article, but shall voluntarily make a correct return and pay the tax due within sixty days thereafter, the withholding agent shall pay, and may not charge to the taxpayer, an additional amount equal to five per centum thereof, but such additional amount shall in no case be less than two dollars, and an additional one per centum for each month or fraction of a month during which the tax remains unpaid.

The Comptroller is authorized to reduce or compromise the penalties provided in the above section.²⁴

SPECIFIC PENALTIES.—The specific penalties, provided in the two following paragraphs, cover cases: (1) when there is no fraudulent intent, (2) when there is fraudulent intent.

LAW. Section 376. . . .

3. **Any individual**, corporation or partnership, who, without fraudulent intent, shall fail to pay, or to deduct or withhold and pay any tax, or to make, render, sign or verify any return, or to supply any information, within the time required by or under the provisions of this article, shall be liable to a penalty of not more than one thousand dollars, to be recovered by the attorney-general in the name of the people by action in any court of competent jurisdiction.

4. **Any individual**, corporation or partnership, or any officer or employee of any corporation, or member or employee of any partnership, who with intent to evade any tax or any requirement of this article or any lawful requirement of the comptroller thereunder, shall fail to pay the tax, or to make, render, sign or verify any return, or to supply any information, within the time required by or under the provisions of this article, or who, with like intent, shall make, render, sign or verify any false or fraudulent return or statement, or shall supply any false or fraudulent information, shall be liable to a penalty of not more than one thousand dollars, to be recovered by the attorney-general, in the name of the people, by action in any court of competent jurisdiction, and shall also be guilty of a misdemeanor and shall,

²⁴See page 118.

upon conviction, be fined not to exceed one thousand dollars or be imprisoned not to exceed one year, or both, at the discretion of the court. . . .

The Attorney-General is authorized to compromise the penalties set forth in paragraphs (3) and (4) above.

Continuing application of old penalty provisions.—

RULING. The Governor on May 10, 1920 signed Chapter 692 of the Laws of 1920, materially changing the provisions of Sections 376 and 377 of the Tax Law. This amendment, effective immediately, affects the possible penalties which may accrue against persons now in default in payment of their income taxes.

Where the act penalized was entirely completed prior to the amendment, penalties accrued under former section 376, are not affected (cf. General Construction Law, Section 93; 1. McKinney Consol. Laws Sections 19, 20), but where the act was not completed on May 10, 1920, but required some further act or failure to act after that date to render the imposition of a penalty proper, the penalty should be computed and enforced under the terms of the amendment.

Thus: if a taxpayer made a return in due time for the taxable year 1919, but (without fraud or negligence) underestimated the amount of his tax, and paid the underestimated amount, no penalty was imposed under former section 376, and no penalty would accrue until thirty days after he had been notified of the deficiency by the Comptroller (old Section 377, paragraph 3). If he paid the deficiency prior to May 10, 1920, no penalty could be imposed or interest charged. But the amended provisions of Section 377, paragraph 3, change the time, within which payment must be made, from thirty days to ten days after notice, and impose interest and penalties under stated circumstances. So that where a taxpayer (without fraud or negligence) made a return but underpaid his tax, and had not paid the difference by May 10, he became subjected to the new provisions. He now will have only ten days after notice, in which to pay the tax, (or ten days from May 10 if notice was given before then), but should add to the amount of the unpaid tax the interest provided for in amended section 377, paragraph 3 (one per cent for each month or fraction from May 10 to date of payment).

If the taxpayer made a return in due time, but negligently or fraudulently underestimated the tax, and only paid the underestimated amount, the negligence or fraud was a completed act prior to May 10 and cannot be penalized under the new provisions, but interest at one per cent per month or fraction from May 10 to date

of payment should be added—for this interest is not a penalty but a charge for the use of moneys due the state. Of course where the underestimate was fraudulent, probably the return itself contains elements of fraud, and the fraudulent act having been committed under the old provisions, it may still be punished under their terms—by prosecution for a misdemeanor (old section 376, paragraph 1) and doubled tax (old section 376, paragraph 3). The doubled tax would carry interest at one per cent per month or fraction from May 10 under the new provisions of Section 377, paragraph 3.

Returns, the time to file which has been extended and not yet expired, will fall entirely within the new provisions.

The power of the Comptroller to waive or reduce additional taxes and interest, conferred by amendment to Section 379 cannot be considered retroactive, and penalties or interest accrued prior to May 10 should be enforced under the old provisions. (Attorney-General's Income Tax Letter No. 32, dated May 14, 1920.)

Compromise of penalties.—Paragraph 2 of section 379 and paragraph 5 of section 376 grant unlimited powers to the Comptroller and the Attorney-General to reduce and compromise penalties imposed by the law.

The Comptroller is authorized to compromise what are known as interest, or *ad valorem*, penalties. The Attorney-General is given the right to compromise all specific penalties.

PENALTIES WHICH MAY BE REDUCED OR COMPROMISED BY COMPTROLLER.—

LAW. Section 379.

2. The comptroller shall have power, upon making a record of his reasons therefor, to waive or reduce any of the additional taxes or interest provided in section three hundred and seventy-six subdivisions one and two, and section three hundred and seventy-seven, subdivision three, of this article, or to compromise the same.

PENALTIES WHICH MAY BE COMPROMISED BY THE ATTORNEY-GENERAL.—

LAW. Section 376.

5. The attorney-general shall have the power, with the consent of the comptroller, to compromise any penalty for which he is authorized to bring action under subdivisions three and four of this section.

It should be noted that the Attorney-General must have the consent of the Comptroller in order to compromise the above-mentioned penalties.

All illegal acts are deemed to have been committed in Albany.—

LAW. Section 376. . . .

6. The failure to do any act required by or under the provisions of this article shall be deemed an act committed in part at the office of the comptroller in Albany. The certificate of the comptroller to the effect that a tax has not been paid, that a return has not been filed, or that information has not been supplied, as required by or under the provisions of this article, shall be prima facie evidence that such tax has not been paid, that such return has not been filed or that such information has not been supplied.

Distribution of Income to Counties

The following section of the law sets forth the manner in which the Comptroller apportions shares of the tax collected to the various counties of the state.

LAW. Section 382. . . . The county treasurer shall apportion the amount so received among the several towns and cities within the county, except a city containing a part of a town, in proportion that the assessed valuation of the real property of each town or city bears to the aggregate assessed valuation of the real property of the county. The county treasurer shall pay the amount so apportioned to each city to the chief fiscal officer of the city to be paid into the general fund for city purposes; and in a county having a population of over three hundred thousand according to the last federal or state census and adjoining a city of the first class having a population of one million and upwards, the county treasurer shall pay the amount so apportioned to the supervisor of the town and such amount shall be by him credited to general town purposes, and such amounts shall not be apportioned as hereinafter provided. If a town does not contain any part of a city or village, the county treasurer shall pay the amount so apportioned to the town to the supervisor of the town and such amount shall be by him credited to general town purposes. If one or more incorporated villages or cities be wholly or partly within a town, the county treasurer shall divide the amount apportioned to such town between such town

and such village, villages or city in the proportions that the assessed valuations of the real property of such town, as appears by the last preceding town assessment-roll, and of the real property of such village, villages or city, or the portion thereof wholly within such town, as appears by the last preceding village or city assessment-roll, bear respectively to the aggregate assessed valuation of the real property of such town and of such village, villages or city, determined by adding together the assessed valuation of the real property of the town, as appears by the last preceding town assessment-roll and the assessed valuation of the real property of such village, villages or city, or the portion thereof wholly within such town, as appears by the last preceding village or city assessment-roll, as the case may be. If two or more villages be entitled to share in such division, the county treasurer shall divide between them the amount to which they are entitled in the proportions that the assessed valuation of the real property of such villages located in the town, as appears by the last preceding village assessment-rolls bears to the aggregate assessed valuations of the real property of such villages located in such town, as so determined. The county treasurer shall pay over to the chief fiscal officer or officers of such village or villages or such city the amount to which such village, villages or city is entitled in accordance with the above apportionment, and shall pay the remaining portion thereof to the supervisor of the town and such amount shall be by him credited to general town purposes.

Examination of Returns by Agencies Other Than the State Comptroller

Generally speaking, the returns filed with the Comptroller must be treated as confidential.

LAW. Section 384. 1. Except in accordance with proper judicial order or as otherwise provided by law, it shall be unlawful for the comptroller, any agent, clerk or other officer or employee to divulge or make known in any manner the amount of income or any particulars set forth or disclosed in any report or return required under this article. Nothing herein shall be construed to prohibit the publication of statistics so classified as to prevent the identification of particular reports of returns and the items thereof, or the inspection by the attorney-general or other legal representatives of the state of the report or return of any taxpayer who shall bring action to set aside or review the tax based thereon, or against whom an action or proceeding has been instituted in accordance with the provisions of sections three hundred and eighty and three hundred and eighty-one of this chapter. Reports and returns shall be preserved for

three years and thereafter until the comptroller orders them to be destroyed. . . .

Returns cannot be used in collateral proceedings.—

RULING. I have considered the question raised by your oral inquiry with respect to subpoenas received from the District Attorney of New York County. These subpoenas call upon you to produce, before the Grand Jury, the income tax returns of certain taxpayers. The proceedings before the Grand Jury do not arise out of any violation of the Income Tax Law, but the returns are sought to show possible evidence of other crimes.

I advise you to disregard these subpoenas for the following reasons:

I think that a "proper judicial order" means an order in some proceeding under the Income Tax Law. I do not regard a subpoena signed only by an attorney as a judicial order, nor do I think that a subpoena even if signed by a court, is a "proper" judicial order except in a case arising under the Income Tax Law.

I think it was the intent of the legislature to make the returns and other information supplied under the Income Tax Law *privileged communications* between the taxpayer and the Comptroller, not to be used in collateral proceedings as evidence, without the consent of the taxpayer. In order to extend the privilege beyond protecting the taxpayer against having his returns used against him in collateral proceedings, and to secure their complete secrecy, a very severe penalty is imposed on anybody divulging or making known *in any manner* any of the particulars of the returns.

The object of this is to give the people confidence and to lessen the natural unpopularity of the tax. The Legislature in effect says to the taxpayer: If you will file a return and pay your tax, you need not fear that statements in the return will ever be used against you in any other connection. Should the returns be subject to subpoena in collateral proceedings, a great incentive would be added to existing incentives to refrain from filing returns and the number of evasions of the tax would accordingly increase.

If the returns are subject to subpoena in collateral actions, they might as well be generally open to public inspection, for nobody could say until after a return had been produced in Court and examined by counsel and the Judge, whether it was relevant to the proceedings before the Court. And there would be nothing to prevent the demand by attorneys for the production, in an examination before trial, on a motion, at a trial, or in other proceedings, of any number of returns, made by persons directly or remotely connected with parties to the proceeding. In a "John Doe" proceeding like that now being conducted before the Grand Jury in New York County, where

no real party defendant is named until an indictment is found, the District Attorney could call for all the returns in your files—a situation obviously never intended by the Legislature to become possible.

The addition of subdivision 3 of Section 384 (L. 1920 c. 60) does not modify my view. The purpose of that subdivision is to make possible the checking up of Federal returns and state returns, or of returns to this state and another state, for the purpose of better enforcement of *income tax laws only*.

In my opinion you should not produce any returns in any collateral proceedings, and I advise you not to do so unless and until the Courts or the Legislature overrule my views. (Attorney-General's Income Tax Letter No. 30, dated April 16, 1920.)

Penalties for disclosing contents of return.—

LAW. Section 384. . . . 2. Any offense against subdivision one of this section shall be punished by a fine not exceeding one thousand dollars or by imprisonment not exceeding one year, or both, at the discretion of the court, and if the offender be an officer or employee of the state he shall be dismissed from office and be incapable of holding any public office in this state for a period of five years thereafter.

When returns may be examined by federal agents and agents of other states.—

3. Notwithstanding the provisions of this section, the comptroller may permit the commissioner of internal revenue of the United States, or the proper officer of any state imposing an income tax upon the incomes of individuals, or the authorized representative of either such officer, to inspect the income tax returns of any individuals, or may furnish to such officer or his authorized representative an abstract of the return of income of any individual or supply him with information concerning any item of income contained in any return, or disclosed by the report of any investigation of the income or return of income of any individual; but such permission shall be granted or such information furnished to such officer or his representative only if the statutes of the United States or of such other state, as the case may be, grant substantially similar privileges to the proper officer of this state charged with the administration of the personal income tax law thereof.

CHAPTER VI

INFORMATION AT THE SOURCE

The principles of withholding and information at the source have been adopted by the state of New York from the federal law with but few modifications.¹ Information returns provide a simple method of checking the accuracy of returns made by recipients of certain classes of payments. Withholding at the source is more or less annoying. Information at the source is not nearly so troublesome and should be quite as effective. It is, however, not worth while to insist on information returns unless use is made of them. The cost of sorting and identifying information reports with individual tax returns is relatively not great when compared with the revenue to be derived from so doing. There are many single persons in New York who receive more than \$1,000 a year in wages. Every one of them should be required to make a return and pay the tax; but it will not be done without the use of information returns. Those who do not comply with the law in regard to information should be penalized for the neglect.

Who shall make returns of information?—

LAW. Section 366. . . .

2. Every withholding agent shall make return to the comptroller of complete information concerning the amounts of all interest, rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments or other fixed or determinable gains, profits and income, except interest coupons payable to bearer, of any taxpayer taxable under this article of one thousand dollars or more in any taxable year under such regulations and in such form and manner and to such extent as may be prescribed by the comptroller. . . .

¹The chief difference is that the Comptroller has no power to demand returns from brokers of profits made by customers, but only information returns of interest paid or credited.

Section 350 defines a "withholding agent" as follows:

LAW. Section 350. . . .

10. The words "withholding agent" include all individuals, corporations, associations and partnerships, in whatever capacity acting, including lessees, or mortgagors of real or personal property, fiduciaries, employers, and all officers and employees of the state, or of any municipal corporation or political subdivision of the state, having the control, receipt, custody, disposal or payment, of interest, rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments or other fixed or determinable annual or periodical gains, profits and income taxable under this article.

REGULATION. The following shall make returns of information to the State Comptroller, Income Tax Bureau, Albany, N. Y. Every

- (a) resident of the state,
- (b) officer and employee of the state,
- (c) officer and employee of a municipal corporation or political subdivision of the state,
- (d) domestic corporation,
- (e) foreign corporation registered within the state,
- (f) individual, corporation, association and partnership maintaining an office or place of business within the state, whether or not a paying agency be maintained within the state,

making payment to a taxpayer of fixed or determinable taxable income of \$1,000 or more in a calendar year. (Art. 281.)

CORPORATIONS AS WELL AS INDIVIDUALS MUST MAKE INFORMATION RETURNS.—Although the income tax in New York is usually considered as an individual matter entirely, note should be made of the fact that *information returns* are required from corporations as well as from individuals making certain payments.

"FIXED OR DETERMINABLE" DEFINED.—"Fixed or determinable" is defined as follows:

REGULATION. . . . Income is fixed when it is to be paid in amounts definitely predetermined. It is determinable whenever there is a basis of calculation by which the amount to be paid may be ascertained. The income need not be paid annually or at an annual rate. It may be paid periodically. The word "periodical" is used in opposition to "annual" and means from time to time, whether or not at regular intervals. That the length of time during which the payments are to be made may be increased or diminished in ac-

cordance with someone's will or with the happening of an event, does not make the payments any the less determinable or periodical.

The following shall be deemed to be fixed and determinable annual or periodical compensation within the meaning of section 366 of the Tax Law:

Any payment made by way of salary, wage, commission, gratuity, emolument, perquisite or otherwise for personal services rendered if the amount thereof shall be

- (a) determined prior to, concurrent with or subsequent to the rendering of the service, and is
- (b) based on personal services rendered by the hour, day, week, month, year or other period of time, or otherwise.

whether such personal service consists of

- (c) the performance of specified or unspecified duties or of
- (d) work done on or in connection with one or more of certain articles or parts thereof;

irrespective of whether payment be made

- (e) in cash,
- (f) in board or lodging, or both,
- (g) in the stock of a corporation,
- (h) by promissory note or other obligation, or
- (i) in property, service or otherwise.

If payment shall be made otherwise than in cash, it shall be considered and treated as payment in cash to the fair market value (determinable usually by understanding or agreement existing between the payor and the payee) of such medium, other than cash, as may be employed.

Fees for professional services are not subject to withholding unless contracted for or paid on an annual or periodical basis. (Art. 263.)

This definition corresponds with the provisions of article 362 (a) of the federal regulations.

Time and place of filing return.—

REGULATION. Returns of information shall be made for the calendar year and shall be filed with the State Comptroller (Income Tax Bureau, Albany, N. Y.) on or before April 15 next following.

Forms to be used.—

The return shall be made on Form 105. The return or returns of information shall be accompanied by a verified letter of transmittal on Form 106.

Information required.—

There shall be reported on such forms the items of information therein called for. Whether the recipient is single, married or the head of a family, is to be stated if possible. Where no present address is available, the last known postoffice address must be given. (Art. 282.)

RETURN OF INFORMATION FOR PAYMENTS IN 1919.—

REGULATION. Returns of information for the calendar year 1919 shall include all payments made during that year, the income tax law being retroactive in this regard to January 1, 1919. (Art. 284.)

What is included in calculating \$1,000 for the purpose of reporting information.—

REGULATION. Returns of information are required of all amounts paid or credited to the same payee by one payor (except as provided in article 289) if they aggregate \$1,000 or more during the calendar year, irrespective of the basis of reporting by the payee or by the payor. The necessity of reporting is not limited to payments of income of a single kind equalling or exceeding \$1,000, but information returns are required if the aggregate payments of income of all kinds, of which returns of information are generally required, equal or exceed \$1,000. For example, if a payor pays to a payee \$600 for personal services, \$250 for rent and \$150 for interest, he is required to report the payments on Form 105, the aggregate of these sums equalling \$1,000. (Art. 285.)

The determining factor in reporting payments made is whether or not the *aggregate* of such payments (after deducting those specifically excluded by article 289²) amounts to \$1,000. The example in the regulation above makes it clear that a report may be necessary even if no payment of any one type exceeds \$1,000. The requirement is a reasonable one, because the recipient may be subject to income tax even though his income from wages or any other single kind of income is less than \$1,000.

Returns of information as to payments for personal service.—

REGULATION. Payments for personal service, equalling or exceed-

²See page 129.

ing \$1,000 for the calendar year, whether such total sum is made up of wages, salaries, commissions or any other compensation, however paid, must be reported. Heads of branch offices and subcontractors employing labor who keep the only complete record of payments therefor, should file returns of information in regard to such payments directly with the State Comptroller. When both main office and branch office have adequate records the return shall be filed by the main office. In the case of an employer having a large number of employees who are moved from place to place as the exigencies of the service require and who has no complete record of annual payments to them at any one place, the average monthly compensation of two representative months may be taken to establish a fair monthly wage and, unless the yearly payment based on this estimate in the case of an employee amounts to \$1,000 or more, no return of information respecting such payments is required. (Art. 286.)

The phrase "or any other compensation" must not be overlooked, especially in those cases in which board or lodging is provided free and really is part of the employee's compensation. As will be seen from article 289,³ however, the amounts paid to employees for board and lodging while traveling are not to be included.

Return of information as to payments of interest on registered bonds.—

REGULATION. Every (a) domestic corporation and (b) registered foreign corporation, making payment to a resident of the state, of interest on registered bonds or other obligations, shall make returns of information thereon if the amount, either of itself or in connection with other payments of income to the same payee, equals or exceeds \$1,000 in a calendar year. Any such corporation may make returns through its fiscal or paying agent. In case the payee is known to be a nonresident of the state no return need be made in respect of him. If the residence of the payee is not known to the corporation or its fiscal or paying agent, it need report only such payments as are made to payees with registered addresses within the state.

Fiscal or other paying agents of (a) states, (b) municipal corporations or political subdivisions of states, (c) foreign governments, or (d) unregistered foreign corporations, are not required to make returns of interest payments. (Art. 287.)

³See page 129.

Return of information as to payment of dividends.—

REGULATION. When directed by the State Comptroller, either specially or by general regulation, every domestic or registered foreign corporation shall render a return of its payments of dividends and distributions to resident stockholders, for such period as may be specified, if the amount paid or distributed to any one stockholder equals or exceeds \$1,000 in a calendar year, stating the name and address of each stockholder, the number and class of shares owned by him and the date and amount of each dividend paid him. If the residence of the payee is not known to the corporation, or its fiscal or paying agent, it need report only such payments as are made to payees with registered addresses within the state. (Art. 288.)

This requirement, although incorporated in the regulations, has not yet been enforced by the Comptroller.

Returns of information by brokers.—

RULING. Replies to the questions submitted . . . today are as follows: 1. No returns of information are required from brokers respecting profits made by their customers in trading securities.

2. Returns of information are required from brokers respecting interest credited or paid on customers' accounts. (Letter to The Corporation Trust Company, signed by Eugene M. Travis, Comptroller, by Mark Graves, Director, Income Tax Bureau, and dated February 25, 1920.)

There is no provision in the state law corresponding to section 255 of the federal law, specifically giving the Comptroller power to demand returns from brokers.

Under articles 285 and 287, a return of information respecting interest paid is required only when the amount, either alone or aggregated with other payments, exceeds \$1,000, although the ruling quoted above would seem to include interest payments of any amount.

Returns of information of rent collections paid by an agent to his principal.—

RULING. In reply to your letter of January 13, you are advised that in making return of information at the source for rents collected, it will be unnecessary for you to render a separate return for each tenant who pays \$1,000 or more. A return in bulk, on form 105, of

all rent collected including rent from tenants paying less than \$1,000 per year, will be sufficient. Only the actual payments which you make to the landlord, should be included in your return. (Official ruling, dated January 14, 1920.)

It will be seen that the object of the framers of the regulations is to obtain information regarding *payments* so that a check may be possible on the *receipts* reported by recipients. Thus the agent collecting rents from various sources need not report the individual items but must report the total, if it exceeds \$1,000, which he pays over to his principal, who is responsible for returning that amount as income. See article 289 (g).

Payments of which no return of information is required.—

REGULATION. Payments of the following classes need not be reported on returns of information:

- (a) Dividends (see article 288),
- (b) Interest coupons payable to bearer (see article 287 for reports of payments of interest on registered bonds),
- (c) Income exempt from taxation under section 359, subdivision 2, of the Tax Law,
- (d) Bills paid for merchandise, telegrams, telephone, freight, storage and similar charges,
- (e) To employees for board and lodging while traveling in the course of their employment,
- (f) Annuities representing the return of capital,
- (g) Of rent, made to real estate agents (but the agent must report payments to the landlord if they equal or exceed \$1,000 annually),
- (h) To nonresident employees, for services rendered entirely without the state,
- (i) To nonresidents, of annuities, including pensions, interest on bank deposits, interest on bonds or other interest-bearing obligations or dividends,
- (j) Fees for professional services, except retainers on an annual or periodical basis,
- (k) To corporations, to partnerships and fiduciaries, and distributions by partnerships to partners and by fiduciaries to beneficiaries. (Art. 289.)

No return of information where there has been actual withholding.—

REGULATION. No return or report shall be made on Forms 105 and 106, of payments of personal service compensation, where there has been actual withholding and report made thereof on Forms 102 and 103 (revised) as provided in Article 270. (Art. 283.)

Information as to actual owner.—

REGULATION. When the person receiving a payment or credit, with respect to which information at the source is required, is not the actual owner of the income received, the name and address of the actual owner shall be furnished upon demand of the State Comptroller, and in default of a compliance with such demand, the payee becomes liable to the penalties provided. (Art. 290.)

Penalties for failure to furnish information.—The subject of penalties is discussed in detail in Chapter V.⁴

⁴See page 92.

CHAPTER VII

PAYMENT OF TAX AT SOURCE

While the principle of payment of tax at the source by withholding is common to both the federal and state laws, the classes of income to which it is applied are not the same in both cases. The state law requires withholding, under certain conditions only, from payments made for personal services, and then only when such payments come within the definition of "fixed and determinable" income.

Summary of Differences Between State and Federal Procedure

Under the state law, withholding and payment at the source is required only from compensation for personal services paid to non-residents and to residents who have not filed form 101. Under the federal law, withholding is required from interest on tax-free covenant bonds paid a resident and in addition on all "fixed or determinable" income of non-resident aliens. (See page 133.)

The rates of withholding under the state law are the same as the rates of tax imposed on net income: 1 per cent on the first \$10,000; 2 per cent on the next \$40,000; and 3 per cent on amounts over \$50,000, in excess of the personal exemption. Under the federal law the rates of withholding are 2 per cent on tax-free covenant bond interest and 8 per cent on "fixed or determinable" payments to non-resident aliens. (See page 133.)

Certificates of residence, form 101 (revised), are required annually of all residents who desire suspension of withholding. Certificates of non-residents claiming exemption, form 102 (revised), must also be filed each year with the withholding agent, who in turn files them with the Comp-

troller on or before April 15. Under the federal practice no residence certificates are required from residents, excepting from resident aliens who are required to file with the withholding agent a certificate of residence, form 1078, who in turn files them with the Commissioner. The certificate is required to be obtained but once. (See page 134.)

No withholding is required if a taxpayer files with the withholding agent a certificate showing that he is a resident of Massachusetts. This is because a resident of Massachusetts is entitled to a credit for the tax he pays in Massachusetts on his New York income which is generally sufficient to offset the New York tax. There is no provision under the federal law for a non-resident alien to secure credit in such manner. (See page 133.)

Returns of tax withheld, on form 103, accompanied by certificates of non-residents claiming exemption, form 102, are to be filed with the Comptroller by April 15 according to article 270, although the law (section 366) states March 15. Under the federal practice the return of tax withheld must be filed by March 1. (See page 142.)

The state law (section 385) provides that any contract to assume income tax is illegal. There is no similar provision in the present federal law. (See page 143.)

Payment of Tax at Source—General

“Withholding agent” defined.—

LAW. Section 350. . . . The words “withholding agent” include all individuals, corporations, associations and partnerships, in whatever capacity acting, including lessees, or mortgagors of real or personal property, fiduciaries, employers and all officers and employees of the state, or of any municipal corporation or political subdivision of the state, having the control, receipt, custody, disposal or payment, of interest, rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments or other fixed or determinable annual or periodical gains, profits and income taxable under this article.

Although the state law is an *individual* income tax law, it should be noted that corporations coming within the definition

of withholding agents have the same statutory duties to perform as have individual employers. The withholding function is that of the payor, whether individual, partnership or corporation, and is a valuable complement to the individual income tax law.

Payments subject to withholding.—

LAW. Section 366. 1. For the calendar year nineteen hundred and twenty and for each calendar year thereafter, every withholding agent shall deduct and withhold from all salaries, wages, commissions, gratuities, emoluments, perquisites and other fixed or determinable annual or periodical compensation of whatever kind and in whatever form paid or received, earned by any taxpayer for personal services and taxable under this article, of which he shall have control, receipt, custody, disposal or payment. . . .

Rate of tax to be withheld.—The law requires that withholding be at the following rates:

LAW. Section 366. 1. . . . one per centum of the first ten thousand dollars or less, two per centum of the next forty thousand dollars or less, and three per centum of the excess over fifty thousand dollars, by which the amount of such compensation paid or to be paid in the calendar year, by such withholding agent to such taxpayer, exceeds the amount of the exemptions granted to such taxpayer under section three hundred and sixty-two of this chapter as shown by a certificate filed with the withholding agent in form to be prescribed by the comptroller or one thousand dollars if no certificate showing his personal exemption status is filed with the withholding agent by a taxpayer other than a resident of this state. . . .

It is to be noted that certificates of residence are required from residents to obviate withholding and from non-residents for the purpose of claiming personal exemptions.

Residents of certain states having personal income tax laws.—

LAW. Section 366. 1. . . . If it appears that another state has passed a law taxing incomes in such manner as will result in its residents being entitled to credit under section three hundred and sixty-three hereof, sufficient to offset all taxes imposed by this article, the comptroller may, by regulation, relieve residents of such state from being required to make any return under this article, and may prescribe

a form of certificate to be filed by residents of such state with withholding agents. . . .

At the present time this provision of the law applies only to residents of Massachusetts. No deduction is made by the withholding agent when the certificate of residence has been filed.¹

No withholding from residents of New York—when.—

LAW. Section 366. 1. . . . A withholding agent with whom such a certificate shall be filed, or with whom a certificate, in such form as shall be prescribed to the comptroller, to the effect that the person entitled to such compensation is a resident of this state and setting forth his residence address, shall be filed after the beginning of the calendar year and before the time when he is required to make return and payment, need not deduct or withhold anything from the compensation of the person filing such certificate. . . .

Comptroller may collect certificates of residence.—

LAW. Section 366. 1. . . . The comptroller may, by regulation, require withholding agents to forward to him at stated times any of the certificates mentioned in this subdivision.

This section of the law has been put into effect in the case of non-residents,² but not as to residents of this state.

Form of residence certificate.—

REGULATION. Form 101 shall be used by residents of the State of New York for the purpose of claiming the benefit of such residence for income tax purposes. Withholding agents shall retain, preserve and keep available for examination and inspection by the Comptroller or his authorized representative all residence certificates for a period of one year next following the close of the calendar year for which such certificates shall have been given. Blanks (Form 101) will be furnished by the Comptroller on the application of withholding agents. Withholding agents may, if they choose to do so, use blanks acquired from other sources, provided, however, that the form and wording thereof shall comply exactly with Form 101. (Art. 267.)

Tax to be withheld unless form 101 is filed.—

RULING. Replying to your letter of January 6th, you are advised that the deducting and withholding provisions of the personal income

¹See article 261 (c), page 137.

²See article 267-a, page 135.

tax law are intended especially to cover the situation mentioned by you. The filing of certificates of residence on Form 101 is simply the test of residence, it being assumed that actual residents of the State will hasten to file such certificates when informed of the law. I reiterate that in all cases where certificates of residence on Form 101 have not been filed with the employer, the tax must be deducted and withheld from the compensation of the employee. (Official ruling, dated January 8, 1920.)

This ruling applies only when the aggregated payments exceed \$1,000 for personal services rendered.

Form of certificate of non-residence and claim for personal exemption.—

REGULATION. Form 102 (revised) shall be used by nonresidents of the State of New York for the purpose of claiming personal exemption. Blanks (Form 102-revised) will be furnished by the Comptroller on the application of withholding agents. Withholding agents may, if they choose to do so, use blanks acquired from other sources, provided, however, that the color, size, form and wording thereof shall conform precisely with Form 102 (revised).

All certificates of nonresidence and claim for personal exemption (Form 102-revised) shall be filed with the State Income Tax Bureau, Albany, N. Y., on or before April 15th following the close of the calendar year for which they were filed, together with the withholding agents' return of tax withheld on Form 103 required by Article 270, and accompanied by payment of tax withheld. (Art. 267-A.)

Certificates of non-residence are to be filed with the Comptroller on or before April 15 in each year.

Renewal of certificates of residence and non-residence and claim for personal exemption.—

REGULATION. A certificate of residence (Form 101) or a certificate of nonresidence and claim for personal exemption (Form 102-revised) shall be effective only for the calendar year in which it is filed. New certificates shall be required by withholding agents for each succeeding year. A nonresident whose personal status changes by reason of marriage or otherwise, after filing a claim for personal exemption, so that he becomes entitled to a greater amount of exemption than previously claimed, may file an amended claim for personal exemption on Form 102 (revised) and deducting and withholding shall apply only against the amount in excess of the personal exemption thus claimed. Any amounts previously withheld in excess of

the amounts thus required to be withheld shall be refunded to such person by the withholding agent without further application on the part of the nonresident.

An employee who has filed a certificate of residence on Form 101, and who at any time before July 1st of any calendar year changes his residence, shall notify his employer of such change. Any employer, who has reasonable ground for believing that an employee has changed his residence before July 1st of any calendar year, shall revoke the certificate of residence theretofore filed by such employee, after notice to the employee, and in default of a new certificate of residence shall deduct and withhold from the compensation of such employee as provided in article 261. (Art. 268.)

Deducting and withholding where residence within the state is established.—

REGULATION. When a withholding agent shall have deducted and withheld from the personal service compensation of an employee, and such employee shall thereafter before the close of the calendar year file with the withholding agent a residence certificate on Form 101, the withholding agent shall thereupon pay over to the employee the entire amount of tax so deducted and withheld for such calendar year.

If such change of residence status is effected prior to July 1 and persists to that date, or is effected on or after July 1, there shall be no deducting and withholding against such employee for that year, but should such employee again become a nonresident during the year before July 1 the deducting and withholding provisions will again become effective in his case, and in that event the withholding shall be on the basis of the aggregate of all payments made during the year to the extent that such payments are in excess of the maximum exemption claimed by him. (Art. 269.)

When deducting and withholding are required.—

REGULATION. Deducting and withholding is required as hereinafter stated with respect to all salaries, wages, commissions, gratuities, emoluments and other fixed or determinable, annual or periodical compensation of whatever kind and in whatever form paid, credited or received, earned by any taxpayer for personal services, taxable under article 16 of the Tax Law.

(a) Where the amount of such compensation for the calendar year is less than \$1,000, no deducting or withholding is required.

(b) Where the taxpayer files with the withholding agent a certificate of residence (Form 101) to the effect that he is a resident

of the State, and setting forth his residence address within the State, no deducting or withholding is required.

(c) Where the taxpayer files with the withholding agent a certificate of nonresidence and claim for personal exemption (Form 102 revised) showing that he is a resident of the Commonwealth of Massachusetts, and setting forth his residence address therein, no deducting or withholding is required.³

(d) In all other cases deducting and withholding is required of one per cent (1%) on the first \$10,000 or less, two per cent (2%) on the next \$40,000 or less, and three per cent (3%) on the excess over \$50,000, by which the amount of such compensation for the calendar year exceeds \$1,000 (if no certificate on Form 102 is filed) or the amount of the exemptions granted to such taxpayer under section 362 of the Tax Law, as shown by a certificate of nonresidence and claim for personal exemption (Form 102 revised) filed with the withholding agent by the taxpayer. (Art. 261.)

Deducting and withholding in 1920.—

REGULATION. Withholding agents shall deduct and withhold as set forth in article 261 in respect of personal service compensation paid or credited to the payee at any time on or after January 1, 1920, except that if the employee left the service of the withholding agent prior to April 14, 1920 and was fully paid prior to that date, no duty or obligation in respect to such payments rests on the withholding agent, unless the status of employer and employee is again created during 1920, and further payments of compensation for personal services are made or credited in 1920. In other words, the provisions for deducting and withholding are effective from January 1, 1920 except as stated in this article. (Art. 262.)

"Fixed or determinable" income—definition.—

REGULATION. Only income earned for personal services is subject to deducting and withholding. The statute specifies that every withholding agent shall deduct from all salaries, wages, commissions, gratuities, emoluments, and perquisites. But other kinds of personal service income may be included if fixed or determinable, annual or periodical. Income is fixed when it is to be paid in amounts definitely predetermined. It is determinable whenever there is a basis of calculation by which the amount to be paid may be ascertained. The income need not be paid annually or at an annual rate. It may be paid periodically. The word "periodical" is used in opposition to "annual" and means from time to time, whether or not at regular intervals. That the length of time during which the payments are to be made may be increased or diminished in accord-

³See article 483, quoted in Chapter XVIII.

ance with someone's will or with the happening of an event, does not make the payments any the less determinable or periodical.

The following shall be deemed to be fixed and determinable annual or periodical compensation within the meaning of section 366 of the Tax Law:

Any payment made by way of salary, wage, commission, gratuity, emolument, perquisite or otherwise for personal services rendered if the amount thereof shall be

- (a) determined prior to, concurrent with or subsequent to the rendering of the service, and is
- (b) based on personal services rendered by the hour, day, week, month, year or other period of time, or otherwise,

whether such personal service consists of

- (c) the performance of specified or unspecified duties or of
- (d) work done on or in connection with one or more of certain articles or parts thereof;

irrespective of whether payment be made

- (e) in cash,
- (f) in board or lodging, or both,
- (g) in the stock of a corporation,
- (h) by promissory note or other obligation, or
- (i) in property, service or otherwise.

If payment shall be made otherwise than in cash, it shall be considered and treated as payment in cash to the fair market value (determinable usually by understanding or agreement existing between the payor and the payee) of such medium, other than cash, as may be employed.

Fees for professional services are not subject to withholding unless contracted for or paid on an annual or periodical basis. (Art. 263.)

The above regulation parallels article 362 of the federal regulations. The wording is not identical, but the underlying principle is the same.

COPYRIGHT ROYALTIES.—

RULING. In your letter of November 15 you inquire if royalties paid to non-residents for books published are subject to the deducting and withholding at the source provisions of the personal income tax law.

You are advised that payments of royalties to writers for the purchase or use of books published are not payments of fixed and determinable annual or periodical compensation for personal services within the meaning of the deducting and withholding at the

source provisions of the law or regulations. (Official ruling, dated November 18, 1919.)

COMMISSIONS PAID TO GENERAL INSURANCE AGENTS AND BY THEM TO THEIR SOLICITING AGENTS.—

RULING. In reply to your letter of October 10 you are advised that the deducting and withholding regulations do not apply with respect to commissions paid to general agents who maintain offices and employ soliciting agents, paying the expenses of the office and the commissions of the soliciting agents out of their receipts of commissions.

The general agent, however, must deduct and withhold with respect to commissions paid by him to soliciting agents, working within the State of New York, who do not file a certificate of residence on Form 101. (Official ruling, dated December 3, 1919.)

The above ruling applies only to payments aggregating \$1,000 or more for personal services rendered.

RENEWAL COMMISSIONS—WITHHOLDING NOT REQUIRED.
—Renewal commissions paid to insurance agents “are not fixed or determinable income, and therefore no withholding of the tax upon them is required by section 366 of the Tax Law.”⁴

Deduction on basis of calendar year.—

REGULATION. Deducting and withholding of personal service compensation by withholding agents shall be on the basis of a calendar year, irrespective of the basis of reporting adopted by the payee-taxpayer. Personal service compensation shall be deemed to have been paid by the withholding agent and received by the payee-taxpayer only if and to the extent actually paid or credited to the payee and thus made reducible to possession by him. Commissions and all other forms of personal service compensation determined and paid or credited to a payee-taxpayer after the close of a calendar year, shall, for the purpose of deducting and withholding the tax and of returning information with respect thereto, be treated as payments made in the calendar year when paid or credited, but for such purposes only. The approved method of accounting employed by the payee-taxpayer shall govern in so far as he may be called upon to account for such payments for income tax purposes. (Art. 264.)

⁴Attorney-General's Income Tax Letter No. 41, dated January 17, 1921.

AT WHAT TIMES AND IN WHAT AMOUNTS SHOULD A WITHHOLDING AGENT WITHHOLD MONEYS?—

RULING. While the act evidently contemplates that usually the withholding agent will withhold a fixed percentage from each periodical payment, no definite requirement to that effect is made. And of course such procedure is not possible with respect to payments made between January 1, and May 14, 1919. It is left to the convenience of the withholding agent, and he will satisfy the requirements of the statute if he pays the tax when it falls due, and makes proper return of information. To protect himself a withholding agent should, before the end of a calendar year, withhold sufficient to pay the tax when it falls due. If he fails to do this he will have a balance to make up under the provision which makes him liable for the tax (§366, (3)). Generally it will be safer for a withholding agent to withhold as he goes—for to rely upon withholding from future payments to pay the tax on past payments may result, in case for instance of the termination of an employment, in the expected future payment never accruing; and to withhold in advance for taxes expected to accrue may lead him into a situation where the prospective tax never accrues and he finds himself in possession of moneys which he cannot justify withholding. (Attorney-General's Income Tax Letter No. 1, question 3, dated May 29, 1919.)

Income not subject to deducting and withholding.—

REGULATION. Deducting and withholding from income is not required:

- (a) In cases enumerated in subdivisions a, b and c of article 261.⁵
- (b) If the income is of a character other than compensation for personal services.
- (c) Where the personal services are rendered entirely without the State, whether payment be made from within or without the State, irrespective of the status of the withholding agent. The occasional entry into the State of a nonresident employee who performs the duties for which he is employed entirely without the State, but enters the State for the purpose of reporting, receiving instructions, accounting, etc., incidental to his duties without the State, shall not be deemed to take such employee out of the class of those rendering their services entirely without the State.
- (d) Where the personal services are rendered within the State if rendered for, and payment is made without the State by, a nonresident individual or partnership having no office or place of business or paying agent within the State, or a foreign corporation

⁵See page 136.

that (1) is not registered in New York and (2) has no office or place of business or paying agent within the State. (Nothing in sub-paragraph "d" shall be construed to relieve the recipient from liability to make return and pay the tax on such income.) (Art. 265.)

The salary of an employee whose services are rendered entirely without the state is not subject to withholding. If the services are performed partly within and partly without the state the provisions of the following article apply.

Income of a non-resident for services performed partly within and partly without the state.—

REGULATION. In case a nonresident receives compensation for personal services rendered or performed partly within and partly without the State, the withholding agent shall deduct and withhold on that portion of the compensation which is earned within the State of New York in accordance with the following rules of apportionment:

(a) If the nonresident is a salesman, drummer, agent or other employee through whose services receipts or remuneration inure directly to the employer, the deducting and withholding shall attach to the portion of the entire salary which the volume of business transacted by the employee within the State of New York bears to the total volume of business transacted within and without the State by such employee.

(b) If the nature of the employment of the nonresident is such that receipts or remuneration for services rendered do not inure directly to the employer, as in the case of clerks, bookkeepers, laborers or other like classes of employees, the deducting and withholding shall attach to the portion of the personal service compensation income of such employee which the time employed within the State bears to the time employed both within and without the State.

(c) If it is not possible to apportion the income as above provided, because of the peculiarities of the service of the employee, the apportionment shall be made in accordance with the facts and the tax deducted and withheld accordingly. In such a case a full statement of the facts shall be made to the Comptroller. (Art. 266.)

The above ruling repeats articles 451 and 452, which deal with the taxability of income earned partly within and partly without the state.

Under the foregoing regulation a non-resident employee of a firm of public accountants who is employed part of the

time in the state of New York and part of the time outside the state would not be subject to withholding on the compensation earned without the state.

Return of tax withheld.—

LAW. Section 366. . . .

3. **Every withholding agent** required to deduct and withhold any tax under subdivision one of this section **shall make return** thereof on or before the **fifteenth day of March in each year** and shall at the same time pay the tax to the comptroller. **Every such individual, corporation or partnership is hereby made liable for such tax and is hereby indemnified against the claims and demands of any individual, corporation or partnership for the amount of any payments made in accordance with the provisions of this section.**

REGULATION. Every withholding agent shall for each calendar year, on or before April 15 next following, make a verified report to the New York State Income Tax Bureau of all sums deducted and withheld from the personal service compensation of employees during that calendar year, in accordance with articles 261 and 262. The return shall be made on Form 103 accompanied by separate reports, one for each individual on Form 102 (revised). There shall be required on such reports the items of information therein called for. The aggregate amount of tax shown to be withheld by the return on Form 103 shall accompany the return. (Art. 270.)

While the above regulation requires that returns from withholding agents, together with the tax deducted, shall be in the hands of the Comptroller on or before *April 15*, the law fixes *March 15* as the date of submission. This discrepancy is unfortunate, as the law (section 377) provides that an interest charge of 6 per cent per annum shall be added "if the time for filing a return by a withholding agent . . . be extended," but taxpayers are justified in acting under the regulation. If feasible, however, returns should be filed by March 15.

When tax required to be withheld is paid by recipient of income.—

LAW. Section 366. . . .

5. . . . If any tax required under this section to be deducted and withheld is paid by the recipient of the income, it shall not be recollected from the withholding agent; nor in cases in which the tax

is so paid shall any penalty be imposed upon or collected from the recipient of the income or the withholding agent for failure to return or pay the same, unless such failure was fraudulent and for the purpose of evading payment.

Returns of information at the source.—

LAW. Section 366. . . .

2. Every withholding agent shall make return to the comptroller of complete information concerning the amount of all interest, rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments or other fixed or determinable gains, profits and income, except interest coupons payable to bearer, of any taxpayer taxable under this article of one thousand dollars or more in any taxable year under such regulations and in such form and manner and to such extent as may be prescribed by the comptroller.

Contract to assume income tax illegal.—

LAW. Section 385. It shall be unlawful for any person to agree or contract directly or indirectly to pay or assume or bear the burden of any tax payable by any taxpayer under the provisions of this article. Any such contract or agreement shall be null and void and shall not be enforced or given effect by any court. . . .

Effect of tax-free covenant in bonds in relation to state income tax.—

RULING. Answering your inquiry of January 17, you are advised that the interest income from the Hudson & Manhattan Railway and the Fonda, Johnstown & Gloversville Railway bonds is taxable income and should be reported as such under the New York State Personal Income Tax Law, even though these bonds contain a New York State tax-free covenant.

In Section 385, it is expressly provided that any contract or agreement to pay, assume or bear the burden of any tax payable by a taxpayer shall be null and void and given no force or effect by any court.

You will, therefore, observe that bonds containing a covenant making them free from New York State Income Tax is without force and effect, and the interest income is taxable the same as from any other bonds. It is true that under the federal law, taxpayers receiving interest on tax-free covenant bonds are entitled to a credit against their tax two per cent of the amount of interest, if the obligor corporation pays the tax to the federal government. The State law does not provide for the payment of tax at the source

by the corporation so, of course, there is no such credit allowed on the State return. (Official ruling, dated January 19, 1920.)

Penalties for failure to withhold tax.—The subject of penalties is discussed in detail in Chapter V.⁶

⁶See page 115 *et seq.*

CHAPTER VIII

INCOME IN GENERAL AND FROM BUSINESS

The law attempts to tax all gains, profits and income from all sources, including business done within the state by residents and non-residents. In addition, residents are taxed on all gains, profits and income from business wherever transacted.

Income from personal services may also be termed business income, but for convenience the regulations and procedure relating thereto will be discussed in Chapter X. Gains or profits arising from sales or exchanges of property, other than by traders, will be discussed in Chapter IX.

In this chapter the following subjects are discussed: Period from which taxable income must be computed; accounting procedure in determining net income; constructive receipt of income; inventories; sales on instalment plan; income from damages, patent infringement, etc.

Summary of Differences Between State and Federal Procedure

(See also Chapters IX, X, XI.)

The first federal income tax law took effect as at March 1, 1913. The New York State income tax law became effective as at January 1, 1919. These two dates therefore are significant in federal and state procedure.

It follows that for state purposes any income accruing prior to the incidence of the tax (January 1, 1919) is not taxable. On the other hand, expenses incurred prior to January 1, 1919, even though paid subsequently, are not deductible. The corresponding date for federal practice, however, is March 1, 1913.

For the purpose of computing profits on the sale of property acquired prior to the incidence of the respective income

tax laws, the significant dates referred to above, viz., January 1, 1919, for state, and March 1, 1913, for federal are used as a basis. Only the excess of selling price over fair market value on the significant date, is taxable income. Similarly only the excess of fair market value on the significant date over the selling price is a deductible loss.

The state grants permission to change from cash to accrual basis or vice versa only when consent of the Commissioner of Internal Revenue has first been obtained. Under federal practice no consent except that of the federal authorities is necessary. (See page 153.)

Under the federal law the undistributed profits of personal service corporations are taxable to stockholders as if they had actually received them. Since the state regards a personal service corporation as a corporation, and not as a partnership, for tax purposes, this phase of state taxation is different from the federal practice. (See page 252.)

The state has not issued specific rulings, as has the federal government, permitting special methods of taking inventories in certain industries (tobacco, lumber, etc.), which methods are peculiarly adapted to the special conditions obtaining in those industries. (See page 160.)

The state law has no provision, as has the federal, whereby a replacement fund may be established instead of taking up the profit when compensation is received for property lost through casualty. (See page 173.)

Income in General

Before discussing specific subjects it is important to consider the general principles upon which the law is based and how far business and financial transactions may be taxed.

"Catch-all" provision.—The state law¹ uses the same language as the federal law.² "Gains or profits and income de-

¹Section 359.

²Federal law, section 213.

rived from any source whatever" are subject to tax. This includes gains arising from the sale of capital assets, from trading, from personal services and from such sources as interest, dividends and rents.

DEFINITION OF "NET INCOME."—The state law³ follows the federal law⁴ in devoting one section, in the case of individuals, to enumeration of the items included and not included in "gross income," and another section to "deductions," and provides for the determination of "net income" by deducting the second from the first. "Net income," less the personal exemptions, is the amount on which the tax is computed.

The definitions of gross and net income in the following regulation are almost identical with those given in the federal regulation.⁵

REGULATION. The tax imposed by the statute is upon income. In the computation of the tax various classes of income must be considered: (a) Income (in the broad sense), meaning all wealth which flows in to the taxpayer other than as a mere return of capital. It includes the forms of income specifically described as gains and profits, including gains derived from the sale, exchange or other disposition of capital assets. It is not limited to cash alone, for the statute recognizes as income-determining factors other items, among which are inventories, accounts receivable, property exhaustion and accounts payable for expenses incurred. (b) Gross income, meaning income (in the broad sense) less income which is by statutory provision or otherwise exempt from the tax imposed by the statute.⁶ (c) Net income, meaning gross income less statutory deductions. The statutory deductions are in general, though not exclusively, expenditures, other than capital expenditures, connected with the production of income. (d) Net income less exemptions. Though taxable net income is wholly a statutory conception, it follows, subject to certain modifications as to exemptions and as to some of the deductions and as to nonresidents, the lines of commercial usage. Subject to these modifications statutory "net income" is commercial "net income." This appears from the fact that ordinarily it is to be computed in accordance with the

³Sections 359, 360.

⁴Federal law, sections 213, 214.

⁵Reg. 45, Art. 21.

⁶See Chapter III.

method of accounting regularly employed in keeping the books of the taxpayer. (Art. 11.)

Income accruing prior to January 1, 1919, not taxable.—The law became effective as at January 1, 1919. All accruals of income prior to that date are deemed to be capital and are not taxable even though collected thereafter. The law purports to tax all income, other than that specifically exempt under the state, accruing after that date.

REGULATION. Property held by the taxpayer on January 1, 1919, is capital. Included in this capital are all claims, whether evidenced by writing or not, and all interest which had accrued thereon before that date. Interest accruing on or after that date is taxable income. Where an interest-bearing claim contracted prior to January 1, 1919, is paid in whole or in part after that date, any gain derived from the conversion of the claim into money is taxable. The amount of such gain is the excess of the proceeds of the claim (both principal and interest), exclusive of any interest accrued since December 31, 1918 (but such interest must be returned as income), over the fair market value of the claim as of January 1, 1919 (both principal and interest then accrued). In the case of an insurance policy its surrender value as of January 1, 1919, may be used as a basis for the purpose of ascertaining the gain derived from the sale or other disposition of such policy. Where services were rendered prior to January 1, 1919, but paid for thereafter, the amount received for such services ordinarily should not be included in gross income. If, however, the value of such a claim on January 1, 1919, was less than the amount received subsequent to that date, the difference should be included in gross income. *A claim for the purpose of this article means a right existing unconditionally on January 1, 1919, and then assignable, whether presently payable or not. Interest does not, of course, include dividends on corporate stock. . . . Dividends declared payable to stockholders of record prior to January 1, 1919, are to be excluded from gross income even if received on or after January 1, 1919. (Art. 79.)

In dealing with an accrual at January 1, 1919, when some uncertainty existed as to the exact accrual or value of an asset, such as a claim for services, for damages or for patent infringement, the test is the actual existence of a valid and valuable claim rather than the unconditional right to assign the claim. In other words, the right to assign might be con-

ditional, but the title and the value is beyond question. It is not believed that taxpayers will have much difficulty with January 1, 1919, valuations if they will take the trouble to appraise their entire property of that date. The reason there is so much difficulty in regard to the March 1, 1913, date under federal practice is that many taxpayers made no effort to ascertain fair values of that date until six or seven years later. It is obvious that the determination of values of a past date becomes increasingly difficult as time passes.

RULING. Answering your inquiry of January 28th, you are advised that in general, the property held by a taxpayer on January 1, 1919, is capital and included in this capital are all claims whether evidenced by writing or not. A claim for this purpose is defined to be a right existing unconditionally on January 1, 1919 and then assignable.

It is further ruled that where no determination or compensation is had until the completion of the service, or if the right to the compensation is conditional upon events occurring after completion of the services, the amount received is income for the taxable year of its determination. Therefore, the amount of a bonus which is paid to a salesman in 1919 as additional compensation for sales made during 1918 and which is conditioned upon the salesman remaining in the service of his employer until April 1, 1919, is taxable income for the year 1919 and must be reported as such. (Official ruling, dated January 30, 1920.)

The foregoing ruling is based on the assumption that there was no evidence or determination of the value of the claim at January 1, 1919. If there had been some vested accrual or partial determination prior to that date the amount accrued prior and subsequent thereto could have been allocated.

Accounting procedure.—The state law is identical with the federal law⁷ in providing that for income tax purposes the same methods of accounting shall be used as are “regularly employed in keeping the books,” unless this “does not clearly reflect the income.”

LAW. Section 358. 1. The net income shall be computed . . . in accordance with the method of accounting regularly employed

⁷Federal law, section 212 (b).

in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made upon such basis and in such manner as in the opinion of the comptroller does clearly reflect the income. . . .

REGULATION. Approved standard methods of accounting will ordinarily be regarded as clearly reflecting income. A method of accounting will not, however, be regarded as clearly reflecting income unless all items of gross income and all deductions are treated with reasonable consistency. See section 350 of the Tax Law for definitions of "paid," "paid or accrued" and "paid or incurred." All items of gross income shall be included in the gross income for the taxable year in which they are received by the taxpayer, and deductions taken accordingly, unless in order clearly to reflect income such amounts are to be properly accounted for as of a different period. For instance, in any case in which it is necessary to use an inventory, no accounting in regard to purchases and sales will correctly reflect income except an accrual method. A taxpayer is deemed to have received items of gross income which have been credited to or set apart for him without restriction. On the other hand, appreciation in value of property is not even an accrual of income to a taxpayer prior to the realization of such appreciation through conversion or other disposition of the property. . . . (Art. 13.)

The last sentence opens the way for the taxation of appreciation when property is transferred by gift. The author is in sympathy with the attempt to deal with gifts as realizations when they are being used to evade tax, but the imposition of an income tax on a donor who realizes nothing but love and affection is of very doubtful legality.

REGULATION. It is recognized that no uniform method of accounting can be prescribed for all taxpayers, and the law contemplates that each taxpayer shall adopt such forms and systems of accounting as are in his judgment best suited to his purpose. Each taxpayer is required by law to make a return of his true income. He must, therefore, maintain such accounting records as will enable him to do so. Among the essentials are the following:

(1) In all cases in which the production, purchase or sale of merchandise of any kind is an income-producing factor, inventories of the merchandise on hand (including finished goods, work in process, raw materials and supplies) should be taken at the beginning and end of the year and used in computing the net income of the year;

(2) Expenditures made during the year should be properly classified as between capital and income, that is to say, that expenditures for items of plant, equipment, etc., which have a useful life extending substantially beyond the year should be charged to a capital account and not to an expense account;

(3) In any case in which the cost of capital assets is being recovered through deductions for wear and tear, depletion or obsolescence any expenditure (other than ordinary repairs) made to restore the property or prolong its useful life should be charged against the property account or the appropriate reserve and not against current expenses.

A taxpayer must make his return on the basis on which his books are kept; so that in making his State return, as in making his Federal return, he must use the basis on which his books are kept, if that basis reflects his true income. (Art. 14.)

The above regulation is identical with the federal requirement, excepting that the last paragraph has been added by the state, very properly putting more insistence on using the book basis.

PERIOD FOR WHICH NET INCOME IS COMPUTED.—

REGULATION. Net income must be computed with respect to a fixed period. Usually that period is twelve months and is known as the taxable year. . . . The time as of which any item of gross income or any deduction is to be accounted for must be determined in the light of the fundamental rule that the computation shall be made in such a manner as clearly reflects the taxpayer's income. If the method of accounting regularly employed by him in keeping his books clearly reflects his income, it is to be followed with respect to the time as of which items of gross income and deductions are to be accounted for. If the taxpayer does not regularly employ a method of accounting which clearly reflects his income, the computation shall be made in such manner as in the opinion of the Comptroller clearly reflects it. (Art. 12.)

The foregoing ruling properly states that the Comptroller may insist on the observance of proper accounting methods. Where such is not the case, it is important that the taxpayer should reform his accounting methods and submit amended returns, because it is hardly to be expected that the Comptroller will exercise his authority unless the taxpayer's methods result in a loss to the state.

The following regulation is identical with the federal regulation.⁸

REGULATION. Each year's return, so far as practicable, both as to gross income and deductions therefrom, should be complete in itself, and taxpayers are expected to make every reasonable effort to ascertain the facts necessary to make a correct return. The expenses, liabilities or deficit of one year can not be used to reduce the income of a subsequent year. A person making returns on an accrual basis has the right to deduct all authorized allowances, whether paid in cash or set up as a liability, and it follows that if he does not within any year pay or accrue certain of his expenses, interest, taxes or other charges, and makes no deduction therefor, he can not deduct from the income of the next or any subsequent year any amounts then paid in liquidation of the previous year's liabilities. A loss from theft or embezzlement occurring in one year and discovered in another is deductible only for the year of its occurrence. Any amount paid pursuant to a judgment or otherwise on account of damages for personal injuries, patent infringement or otherwise, is deductible from gross income when the claim is put in judgment or paid, less any amount of such damages as may have been compensated for by insurance or otherwise. If subsequent to its occurrence, however, a taxpayer first ascertains the amount of a loss sustained during a prior taxable year which has not been deducted from the gross income, he may render an amended return for such preceding taxable year, and may file a claim for refund of the excess tax paid by reason of the failure to deduct such loss in the original return. (Art. 123.)

The foregoing article must not be taken too literally. No business includes every item of income and expenses in closing its books. Small items frequently turn up afterward, and it would be foolish and impracticable to charge or credit such items to a prior period and to prepare amended tax returns. But when items applicable to a prior period are substantial in amount, amended returns should be made.

CASH OR ACCRUAL METHOD OF COMPUTING NET INCOME.—

LAW. Section 350. . . .

6. The word "paid" for the purposes of the deductions and credits under this article means "paid or accrued" or "paid or incurred," and the terms "paid or incurred" and "paid or accrued" shall be construed according to the method of accounting upon

⁸Reg. 45, Art. III.

the basis of which the net income is computed, under this article. The term "received" for the purpose of the computation of net income under this article, means "received or accrued" and the term "received or accrued" shall be construed according to the method of accounting upon the basis of which the net income is computed under this article. . . .

The last sentence of the above paragraph does not appear in the federal law, but it applies the principle found in the first paragraph, which is identical with the federal law.⁹

CHANGING FROM CASH TO ACCRUAL BASIS.—The state requirements for changing from a cash to an accrual basis are identical with the federal, excepting that in addition the taxpayer must file with the state a copy of the consent of the Commissioner of Internal Revenue. It appears that a change in method will be permitted by the state only when permission to change the basis of the federal return has been obtained.

REGULATION. . . . A taxpayer who changes the method of accounting employed in keeping his books for the taxable year 1920 or thereafter, shall before computing his income upon such new basis for purposes of taxation secure the consent of the Comptroller. Application for permission to change the basis of the return shall be made at least 30 days in advance of the date of filing return and shall be accompanied by a statement specifying the classes of items differently treated under the two systems and all amounts which would be duplicated or entirely omitted as a result of the proposed change. A taxpayer subject to Federal tax shall file with his application a copy of the consent of the Commissioner of Internal Revenue, to change the basis of the return for Federal tax purposes. The requirement of notice to the Comptroller will be modified in such cases with respect to time, and where a change is authorized, it will be made effective at the same date as that authorized by the Commissioner of Internal Revenue. (Art. 13.)

"CONSTRUCTIVE" RECEIPT.—

REGULATION. Income which is credited to the account of or set apart for a taxpayer and which may be drawn upon by him at any time is subject to tax for the year during which so credited or set apart (unless previously accrued by the taxpayer and included in his return of income), although not then actually reduced to possession. To constitute receipt in such a case the income must be credited to

⁹Federal law, section 200.

the taxpayer without any substantial limitation or restriction as to the time or manner of payment or condition upon which payment is to be made. A book entry, if made, should indicate an absolute transfer from one account to another. If the income is not credited, but is set apart, such income must be unqualifiedly subject to the demand of the taxpayer. For example, where a corporation contingently credits its employees with bonus stock, but the stock is not available to such employees until the termination of five years of employment, the mere crediting on the books of the corporation does not constitute receipt. The distinction between receipt and accrual must be kept in mind. Income may accrue to the taxpayer and yet not be subject to his demand or capable of being drawn on or against by him. (Art. 45.)

TAXATION OF UNCOLLECTED INTEREST COUPONS AND DIVIDEND CHEQUES.—The following is identical with the federal ruling,¹⁰ excepting that under the state law profits earned by personal service corporations, not distributed as dividends, are not considered as “constructively” received by the stockholders, as is the case under the federal law. The earnings of partnerships, however, are so considered, whether they are distributed or not.¹¹

REGULATION. Where interest coupons have matured, but have not been cashed, such interest, though not collected when due and payable, is nevertheless available to the taxpayer and should therefore be included in his gross income for the year during which the coupons matured unless the debtor be in default. This is so although the coupons are exchanged for other property instead of eventually being cashed. Dividends on corporate stock are subject to tax in the year in which made payable, although not yet collected by the stockholder. The distributive share of the profits of a partner in a partnership is regarded as received at the close of the partnership's fiscal year. . . . Interest credited on savings bank deposits, even though the bank nominally has a rule, seldom or never enforced, that it may require a stipulated number of days' notice in advance of cashing depositors' checks, is income to the depositor when credited. . . . (Art. 46.)

It may be that taxpayers in good faith will depart somewhat from the foregoing regulation. It is probable, however,

¹⁰Reg. 45, Art. 54.

¹¹See Chapter XVI.

that a substantial rather than a literal observance will be sufficient. Taxpayers who keep their books on a cash basis would have difficulty from year to year if they attempted to include dividends on the dates when payable by the corporations instead of the dates of receipt by the taxpayers. On January 2, a taxpayer will receive in the same mail dividends payable December 31, and others payable January 2. It would be confusing and an unnecessary hardship to require the taxpayer to ascertain the dates upon which dividends were payable. It would be a sufficient compliance with the law to prepare returns from one's cheque-book.

Foreign exchange.—

RATE OF EXCHANGE ON INCOME ACCRUING ABROAD.—The state has adopted the same method as that described in the federal rulings, prescribing the use of the rate current at the date of the transaction.¹²

RULING. In reply to your recent verbal inquiry, you are advised that in the case of a resident taxpayer who has accruing to him from time to time income from foreign countries, such taxpayer should return such item of income at the rate of exchange prevailing on the date it is credited to his account abroad. All former rulings to the contrary in such cases are hereby superseded. (Official ruling authorized for publication, signed by James A. Wendell, Comptroller, by Mark Graves, Director, Income Tax Bureau, and dated January 26, 1921.)

FOREIGN BRANCHES.—The above ruling applies to isolated transactions. When an individual or a partnership has branches abroad, presumably the state will follow the Federal practice and permit the inventorying of current assets and current liabilities at the close of the taxable year based on the rate of exchange in force on the closing date.

¹²[Former Procedure] The state formerly prescribed the use of the "rate of exchange prevailing at the time of the actual receipt in this country" (official ruling, dated December 30, 1919), but the inconsistency of this ruling with the state's doctrine of "constructive receipt" would not permit it to stand.

Income from Business

As heretofore stated, the term "business income" is broad enough to include more sources of revenue than are considered in this chapter. The following discussion is limited to the specific classes of income indicated by the subject headings.

LAW. Section 359. The term "**gross income**":

1. **Includes** gains, profits and **income derived from . . . trades, businesses, commerce, or sales, or dealings in property**, whether real or personal, growing out of the ownership or use of or interest in such property;

"Gross income from business" defined.—

REGULATION. In the case of a manufacturing, merchandising or mining business "gross income" means the total sales, less the cost of goods sold, plus any income from investments and from incidental or outside operations or sources. In determining the gross income subtractions should not be made for depreciation, depletion, selling expenses or losses, or for items not ordinarily used in computing the cost of goods sold.¹⁸ (Art. 28.)

Business need not be lawful.—Gains from gambling or speculation, while not specifically mentioned, come within the meaning of the words "any business carried on for profit."

Computation of business income of contractors.—

REGULATION. Persons engaged in contracting operations, who have uncompleted contracts, in some cases perhaps running for periods of several years, will be allowed to prepare their returns so that the gross income will be arrived at on the basis of completed work; that is, on jobs which have been finally completed any and all moneys received in payment will be returned as income for the year in which the work was completed. If the gross income is arrived at by this method, the deduction from gross income should be limited to the expenditures made on account of such completed contracts. In arriving at the gross income by this method the receipts and expenditures relating to jobs commenced prior to 1919 must be included if completed in 1919 or subsequent years. Or the percentage of profit from the contract may be estimated on the basis of percentage

¹⁸The use of recognized accounting methods is permitted, and the taxpayer's method of accounting need not be changed in order to ascertain items of "gross income."

of completion, in which case the income to be returned each year during the performance of the contract will be computed upon the basis of the expenses incurred on such contract during the year; that is to say, if one-half of the estimated expenses necessary to the full performance of the contract are incurred during one year, one-half of the gross contract price should be returned as income for that year. Upon the completion of a contract if it is found that as a result of such estimate or apportionment the income of any year or years has been overstated or understated, the taxpayer should file amended returns for such year or years. (Art. 29.)

The requirement in the above regulation that "receipts and expenditures relating to jobs commenced prior to 1919 must be included in 1919" is correct only so far as a complete detailed statement of each open contract on January 1, 1919, may be necessary in order to compute the profit or loss accrued to that date. The law does not attempt to tax profits accrued prior to January 1, 1919.

Reserve for discounts.—It is the practice of the federal government to allow discounts actually taken in a succeeding year before the return is filed, and the following regulation, which is similar to the federal ruling, confirms the practice of deducting the amount added to a reserve, which is a real liability.

REGULATION. If a taxpayer computes his income upon the basis of valuing his notes or accounts receivable at their fair market value when received, which may be less than their face value, the amount deductible for bad debts in any such case is limited to such original valuation. (Art. 161.)

Inventories

The state law not only employs the same language as the federal law¹⁴ in prescribing the use of inventories, but it also provides specifically for conforming to the methods of the federal government.

LAW. Section 356. Whenever in the opinion of the comptroller the use of inventories is necessary in order clearly to determine the

¹⁴Federal law, section 203.

income of any taxpayer, inventories shall be taken by such taxpayer upon such basis as the comptroller may prescribe, conforming as nearly as may be to the best accounting practice in the trade or business and most clearly reflecting the income, and conforming so far as may be to the forms and methods prescribed by the United States commissioner of internal revenue under the act of congress known as the revenue act of nineteen hundred and eighteen.

When stocks of goods are maintained, an inventory should be taken to determine profit or loss.

REGULATION. In order to reflect the net income correctly, inventories at the beginning and ending of each year are necessary in every case in which the production, purchase or sale of merchandise is an income-producing factor. . . . (Art. 216.)

Inventories at January 1, 1919, should have been adjusted.—The rule of “cost or market whichever is the lower,” which governs the valuation of inventories, is applicable to going businesses and is adapted to conservative rather than to exact methods.

The law became effective January 1, 1919, and clearly provides that all losses or profits thereafter shall be computed by taking as a basis the fair value of property at January 1, 1919.¹⁵ Inventories taken at cost December 31, 1918, when cost was less than market, should have been adjusted to market for state tax purposes. Inventories taken at market required no adjustment. Inventories which were taken at cost December 31, 1918, irrespective of market, also should have been adjusted.

It is believed that a compliance with the law in most cases will result in a saving of taxes, because very few inventories at December 31, 1918, were taken above the prevailing market values.

What “inventory” includes.—

REGULATION. . . . The inventory should include raw materials and supplies on hand that have been acquired for sale, consumption

¹⁵Section 353.

or use in productive processes, together with all finished or partly finished goods. . . . (Art. 216.)

If a book inventory is trustworthy and the entire stock is verified in whole or in part at various times during the year, such inventory may be used instead of a physical inventory, but a mere estimate is not permissible.

Basis of inventory valuations.—

REGULATION. Inventories should be valued at (a) cost or (b) cost or market, as defined in article 219 as amended, whichever is lower. Whichever basis is adopted must be applied consistently to the entire inventory. A taxpayer may, regardless of his past practice, adopt the basis of "cost or market whichever is lower" for his 1920 inventory, provided a disclosure of the fact and that it represents a change are made in the return. Thereafter changes can be made only after permission is secured from the Comptroller. Inventories should be recorded in a legible manner, properly computed and summarized, and should be preserved as part of the accounting records of the taxpayer. Goods taken in the inventory which have been so intermingled that they cannot be identified with specific invoices, will be deemed to be the goods most recently purchased. (Art. 217, revised January 11, 1921.)

Recognizing the abnormal conditions at the close of 1920, when the market value of nearly all commodities was falling, in contrast to the conditions at the end of 1919, when prices were rising to abnormal heights, the state followed the action of the federal authorities in permitting the use of "cost or market, whichever is lower," instead of "cost" in pricing inventories at the end of 1920, regardless of the taxpayer's prior practice.¹⁶

Inventories at cost.—

REGULATION. Cost means:

(1) In the case of merchandise purchased, the invoice price less trade or other discounts except strictly cash discounts approximating a fair interest rate, which may be deducted or not at the option of the taxpayer provided a consistent course is followed. To this

¹⁶Reg. 45, Art. 1582, was amended December 30, 1920, and reads the same as the revised state regulation (article 217) quoted above.

net invoice price should be added transportation or other necessary charges incurred in acquiring possession of the goods.

(2) In the case of merchandise produced by the taxpayer, (a) the cost of raw materials and supplies entering into or consumed in connection with the product, (b) expenditures for direct labor, (c) indirect expenses incident to and necessary for the production of the particular article, including in such indirect expenses a reasonable proportion of management expenses, but not including any cost of selling or return on capital whether by way of interest or profit. In any industry in which the usual rules for computation of cost of production are inapplicable, costs may be approximated upon such basis as may be reasonable and in conformity with established trade practice in the particular industry. (Art. 218.)

AVERAGE COST AND OTHER METHODS.—The federal authorities have permitted in certain industries (tobacco and lumber)¹⁷ an average cost method, as representing the practice peculiar to those industries. Farmers have been permitted the use of the “farm price” method (market price, less cost of marketing), and retail drygoods dealers the “retail” method, which is described as a “cost” method. The state rulings are silent on these special methods, but the state presumably will follow the federal practice.

Inventories at market.—

REGULATION. Under ordinary circumstances “market” means the current bid price prevailing at the date of the inventory for the particular merchandise in the volume in which ordinarily purchased by the taxpayer. This method of valuation is applicable in the cases (a) of goods purchased and on hand, (b) of basic elements of cost (materials, labor and burden) in goods in process of manufacture, and (c) of finished goods on hand; exclusive, however, of goods on hand or in process of manufacture for delivery upon firm sale contracts at fixed prices entered into before the date of the inventory, which goods must be inventoried at cost. Where no open market quotations are available, the taxpayer must use such evidence of a fair market price at the date or dates nearest the inventory as may be available, such as specific transactions in reasonable volume entered into in good faith, or compensation paid for cancellation of contracts for purchase commitments. Where, owing to abnormal conditions, the taxpayer has regularly sold such mer-

¹⁷See *Income Tax Procedure*, 1921, page 345.

chandise at prices lower than the current bid prices as above defined, the inventory may be valued at such prices, and the correctness of such prices will be determined by reference to the actual sales of the taxpayer for a reasonable period before and after the date of the inventory. Prices which vary materially from the actual prices so ascertained will not be accepted as reflecting the market and the penalties prescribed for filing false and fraudulent returns may be asserted. Goods in process of manufacture may be valued for purposes of the inventory on the lowest of the following bases: (1) the replacement or reproduction cost prevailing at the date of the inventory; or (2) the proper proportionate part of the actual finished cost; or, under abnormal conditions, (3) the proper proportionate part of the sales price for the finished product, account being taken in all cases of the proportionate part of the total cost of basic elements (materials, labor and burden) represented in such goods in process of manufacture at the stages at which they are found on the date of the inventory. The inventories of taxpayers on whatever basis taken will be subject to investigation by the Comptroller, and the taxpayer must satisfy the Comptroller of the correctness of the prices adopted, and must be prepared to show both the cost and the market price of each article included in the inventory. (Art. 219, revised January 11, 1921.)

The foregoing regulations in recognizing abnormal conditions throw a considerable amount of responsibility on the good judgment and good faith of the taxpayer.

It may be noted that article 219 rules that market "means the current bid price prevailing at the date of the inventory." Later on, however, in the same article it is recognized that abnormal conditions prevent the usual procedure regarding the determination of market prices. Generally speaking, an inventory based on current bid prices would enable most inventories taken on December 31, 1920, to be priced very low, as in many commodities the bid prices were based on overstocks.¹⁸ The definition in the regulations, therefore, should not be taken literally by the taxpayer, but should be read with the context.

Many users of steel products had placed large orders for steel when the general price decline came. The demand for

¹⁸For statement of the Commissioner regarding inflated prices of the war period, see *Income Tax Procedure*, 1919, pages 1088 and 1089 (Supp.).

their finished product vanished overnight, particularly in the automobile industry, yet the price of forgings and other raw material showed no decline because the steel mills had large accumulated orders on their books. Using the "current bid price prevailing at the date of the inventory" would compel these manufacturers to pay taxes at the high rate on these enormous inventories which they probably will not be able to liquidate even by the end of next year.

In connection with an interpretation of the terms (1) cost, (2) cost or market, whichever is lower, questions have arisen as to whether or not certain items in an inventory may be priced at cost (which is less than market) and other items of exactly the same kind, which cost more, may be reduced to market. For illustration, certain lots of pig iron may have cost \$20 a ton. Other lots may have cost \$25, and additional lots may have cost \$30. When inventory is taken the market price is \$25. When the lots can be readily identified, the first lot should be kept at cost, viz., \$20 a ton; the second lot should be kept at market, viz., \$25 a ton; and the third lot should be marked down to market, viz., \$25 a ton.

Article 217 still implies that *in the same inventory* some items may be taken at cost and some (when the market has dropped) at less than cost. No other method would properly interpret the term "cost or market whichever is lower" nor conform to good accounting practice.

There seems to have been some confusion in the minds of taxpayers as to the practical application of the "cost or market whichever is lower" method. Ordinarily it is not feasible to segregate or identify the various lots which were sold or still remained in stock. To do so involves a minute segregation of accounts, such as is found in a comprehensive cost system. In the ordinary course the stock purchased first must be assumed to be the stock sold first, and the stock to be inventoried would be that last purchased. The cost of these last lots is compared with the market price, and the lower of the two is taken.

Are the inventory regulations in accord with accounting procedure?—The regulations quoted above are in accord with sound commercial practice, assuming that “market price” will be construed to mean a fair and reasonable price.

Inventories should be valued at “cost or market, whichever is the lower,” except when trade conditions or long-continued custom call for a still lower basis. “Market” means in effect the replacement cost of the goods at the date of the inventory, but subject to the desirability of replacing and the possibility of replacing at a lower price at a later date. Apparent market prices may not be true market prices. This is particularly the case in a falling market, but may be equally true when a rising market indicates speculative prices arising from shortages (which may be temporary). In such cases goods purchased at the speculative prices may appear at inventory time to be worth cost and the apparent market price may be even higher, but a conservative concern would hesitate before recognizing such values as real. Therefore, no matter how staple or salable the goods may be, if the market price has declined the inventory should be reduced to correspond. For many other reasons merchandise may have to be inventoried below cost: overstock; damage or deterioration; changes in styles and shapes; obsolescence—going out of date; sizes and qualities seldom used; broken lots, etc.¹⁹

Portions of inventories usually priced at less than either cost or market.—In some cases it will be necessary to continue to price portions of an inventory at less than either cost or market. Businesses such as those of agricultural implement and automobile manufacturers frequently find that they have on hand large stocks of spare parts which are not worth cost or the nominal market.

As a matter of fact, small quantities may be selling freely

¹⁹For full discussion of factors which influence inventory valuations, see *Auditing, Theory and Practice* (2nd edition), by R. H. Montgomery, pages 84-95.

and at a very high rate of profit. But inventories must not be taken on the supposition that an entire stock is worth as much proportionately as a small part. A hatter might have in stock 100 perfectly good hats. He might sell 50 of them at a good profit. If he then took stock and, from experience, knew that the most the future market would absorb would be 40, ordinary business practice would require him to inventory 40 at cost or market, whichever was the lower, or 50 at the same aggregate price, but at a less unit price. This is not a departure from but is an adherence to the principle of inventory valuation which conforms "to the best accounting practice." Future demand is one of the controlling factors in the determination of market prices.

Obsolete stock may be written down or off.—The principle of cost or market, when applied to inventory items which have become obsolete or nearly so, is feasible. If there were a reasonable demand for the items they would not be classed as obsolete. If the demand has definitely fallen off or has ceased, the market value has correspondingly declined and such stock may, in accordance with the principle, be written down to its market value or marked off entirely if it has no market value.

In many branches of industry, notably automobile manufacture, new designs have rendered obsolete much of the finished goods carried in the inventory. When this is known before the end of the year, the obsolescence is certainly definite and should be reflected in the inventory values.

Market value of goods in process and finished goods.—One of the most difficult problems of manufacturers arises from work in process and finished goods.

This question is of major importance in a time of demoralized markets, such as confronted so many industries at the close of 1920.

The following comparison illustrates the problem:

FINISHED GOODS		
	Actual Cost	Replacement Cost, i. e., Actual Market
Material	\$100	\$ 50
Labor	200	120
Overhead	200	200
Totals	\$500	\$370

This assumes that material has declined 50 per cent and labor 40 per cent. Overhead may remain at the same figure or be changed.

Work in process should be valued by applying the ratios of decline thus obtained to the *actual* cost of the goods-in-process inventory. Different stages of completion will require adjustment.

The federal authorities permit the foregoing adjustment of material prices and also permit the replacement basis in labor and expense items. The physical property which is inventoried is goods in process (or finished goods). If goods and wages have declined, the product of goods and wages declines in value. An inventory is not at "market" unless it is adjusted to what is practically a replacement basis at the date of the inventory.

In addition to the present cost of replacement, consideration should be given to the selling prices in effect for such goods, goods in process and finished goods at the present time. Such goods for inventory purposes should be valued at not more than their selling value less shipping or other costs yet to be incurred.

The selling price of goods is a measure of the demand for them and a supplemental indication of their present market value, even when market value is considered from a replacement rather than a sales point of view.

Goods sold for future delivery.—Article 219²⁰ provides that goods sold for delivery at fixed prices entered into before

²⁰See page 160.

and on hand at date of inventory must be inventoried at cost. If sold at prices which yield a normal profit the requirement is sound, provided, however, that there is no possibility of cancellation and that the credit of the buyer is beyond question.

When goods for future delivery have been sold at a loss they should be inventoried at market, as if they had not been sold.

The following authoritative statement has been made public by the American Institute of Accountants:²¹

The treatment of inventories by companies having contracts for sale of goods at prices yielding a profit above cost was considered. It was agreed that where goods have been bought specifically for such contracts, they should be taken at cost even if that be higher than market, both for general accounting and tax purposes. This should apply only if the contracts are enforceable contracts with responsible people—not in cases where enforcement would involve such risk of a bad debt as to be unwise. It was recognized that the question as to applying goods on hand to such contracts where they were not earmarked was difficult, and the firm (of accountants) should not be disposed to question any reasonable course adopted by any client in this matter.

Goods purchased but not delivered.—

REGULATION. . . . Title to the merchandise included in the inventory should be vested in the taxpayer and goods merely ordered for future delivery and for which no transfer of title has been effected should be excluded. The inventory should include merchandise sold only if title has not passed to the purchaser; but if title has passed to the purchaser and such goods have been included in the sales of the taxable year, they should not be taken in the inventory. It should also include merchandise purchased, although not actually received, to which title has passed to the purchaser. In this regard care should be exercised to take into the accounts all invoices or other charges in respect of merchandise properly included in the inventory, but which is in transit or for other reasons has not been reduced to physical possession. (Art. 216.)

The foregoing ruling properly permits taxpayers to inventory unshipped goods when title has passed. In such cases

²¹Special Bulletin No. 7, December, 1920.

the sellers of the goods should take up the transactions as accounts receivable.

Dealers in securities may use inventory method.—

REGULATION. A dealer in securities, who in his books of account regularly inventories unsold securities on hand either (a) at cost or (b) at cost or market value, whichever is lower, may make his return upon the basis upon which his accounts are kept; provided that a description of the method employed shall be included in or attached to the return, that all the securities must be inventoried by the same method, and that such method must be adhered to in subsequent years, unless another be authorized by the Comptroller. For the purpose of this rule a dealer in securities is a merchant of securities, whether an individual or partnership, with an established place of business, regularly engaged in the purchase of securities and their resale to customers, that is, one who as a merchant buys securities and sells them to customers with a view to the gains and profits that may be derived therefrom. If such business is simply a branch of the activities carried on by such person, the securities inventoried as here provided may include only those held for purposes of resale and not for investment. Taxpayers who buy and sell or hold securities for investment or speculation, and not in the course of an established business, and officers of corporations and members of partnerships, who in their individual capacities buy and sell securities, are not dealers in securities within the meaning of this rule. (Art. 220.)

In the case of "short sales" the federal rulings²² do not permit the market value of the stock sold short to be used as an offset to the sale, i.e., as an inventory item. Presumably the state will follow the same procedure. The question is a debatable one and there is much to be said in favor of dealers' inventorying "short" sales as well as stocks or other property purchased.

INVENTORIES OF DEALERS IN SECURITIES AT JANUARY 1, 1919.—

RULING. Answering your inquiry of February 27th, you are advised that a dealer in securities is required to value inventories taken on January 1st, 1919, at their fair market value as of that date. Subsequent inventories made, however, may be taken in either of the

²²*Income Tax Procedure*, 1921, page 360.

following methods: (a) At cost, or (b) Cost or market, whichever is lower.

When either of the above methods is adopted for the inventory at the close of 1919, a change thereafter from such method can be made only when permission is given by the Comptroller.²³

It will be in accordance with the State regulations if you prepare your returns for 1919 on the basis of inventory of securities at January 1, 1919 market values and close the year with the inventory of securities at cost. (Official ruling, dated March 2, 1920.)

The foregoing ruling is probably sound, because January 1, 1919, inventories were not subject to the rules of going businesses but should have been adjusted to accord with the effective date of the law. It is not believed that many taxpayers calculated their inventories for federal purposes one way and for state purposes another way, but it should have been done.²⁴

RETURNS OF DEALERS IN SECURITIES.—A “dealer in securities” in reporting on form 201 would use schedule 25. On line (e) would be entered the sale price of all securities sold, and on line (i) would be entered the cost price of securities purchased. When the dealer has kept his books on the accrual basis and has taken inventories, lines (j) and (l) should be used to record the inventories at the beginning and the end of the year. If it is not feasible for a dealer in securities to enter the gross sales price on line (e), because his books show only gross profits, he should then enter the item of gross profits on line (e) and not attempt to set up the cost of securities on line (i).

Speculators or investors, if they cannot qualify as dealers in securities, even though they carry on many hundreds of transactions, must report under schedule 27, and if books are not kept showing the details of each transaction, with profit or loss, the Comptroller would be justified in requiring such information. Without such compilation the taxpayer himself does not know what his profits or losses have been.

²³This provision is extended to 1920; see page 160 *et seq.*

²⁴See page 158.

RULING. Yesterday you submitted an oral inquiry, which, as I remember it, was as follows:

If one who trades in stocks and bonds enters in the proper column on Form 201, after letter "c" of inquiry 27, the loss or gain from sales or exchanges of stocks and bonds, will that be accepted by the department even though the taxpayer fail to enter the information called for after letters "a" and "b" of the same inquiry; that is (a) sale price (or fair market value of property received in exchange) and (b) the cost (or fair market value on January 1, 1919, if acquired prior thereto)? [Refers to 1919 form.]

Let me answer by saying that the department will accept returns where only the resultant gain or loss is stated, but the taxpayer must be in position to establish, if called upon so to do, the sale price (or fair market value of property received in exchange) and the cost (or fair market value on January 1, 1919), and must keep and preserve the records or reports from which the accuracy of his return can be verified. (Official ruling, dated January 14, 1920.)

Miscellaneous

Income from sale of property on the instalment plan.—

REGULATION. Dealers in personal property ordinarily sell either for cash, or on the personal credit of the buyer, or on the installment plan. Occasionally a fourth type of sale is met with, in which the buyer makes an initial payment of such a substantial nature (for example, a payment of more than 25 per cent) that the sale, though involving deferred payments, is not one on the installment plan. In sales on personal credit, and in the substantial payment type just mentioned, obligations of purchasers are to be regarded as the equivalent of cash, but a different rule applies to sales on the installment plan. Dealers in personal property who sell on the installment plan usually adopt one of four ways of protecting themselves in case of default; (a) through an agreement that title is to remain in the seller until the buyer has completely performed his part of the transaction; (b) by a form of contract in which title is conveyed to the purchaser immediately, but subject to a lien for the unpaid portion of the purchase price; (c) by a present transfer of title to the purchaser, who at the same time executes a reconveyance in the form of a chattel mortgage to the seller; or (d) by conveyance to a trustee pending performance of the contract and subject to its provisions. The general purpose and effect being the same in all of these plans, it is desirable that a uniformly applicable rule be established. The rule prescribed is that in the sale or contract for sale of personal property on the installment plan, whether or not title remains in the vendor until the property is fully paid for, the income to be returned

by the vendor will be that proportion of each installment payment which the gross profit to be realized when the property is paid for bears to the gross contract price. Such income may be ascertained by taking that proportion of the total payments received in the taxable year from installment sales (always including payments received in the taxable year on account of sales effected in earlier years as well as those effected in the taxable year) which the gross profit to be realized on the total installment sales made during the taxable year bears to the gross contract price of all such sales made during the taxable year. Where a change is made to this method of computing net income the taxpayer's balance sheet should be adjusted conformably as of the date when the change is effected. If for any reason the vendee defaults in any of his installment payments and the vendor repossesses the property, the entire amount received on installment payments, less the profit already returned, will be income of the vendor for the year in which the property was repossessed, and the property repossessed must be included in the inventory at its original cost to himself, less proper allowance for damage and use, if any. If the vendor chooses as a matter of consistent practice to treat the obligations of purchasers as the equivalent of cash, such a course is permissible. If sales during prior years contain a different percentage of profit than those of the taxable year, or if for any other reason, corrections are required to produce a more accurate result, they can be made as of the end of the taxable year. (Art. 34.)

The above regulation is identical with the federal ruling on this subject prior to its amendment in the latter part of 1920. As amended, the federal ruling makes two important changes:²⁵

1. Any collections applicable to installment sales already reported as income are credited to accounts receivable. No part of such items is used in computing realized profits for the taxable year. This avoids double taxation.

2. Collections as made are segregated to show the years to the sales of which they apply. Segregation is also made in the books for each year of—

- (a) Sales
- (b) Gross profit (unrealized)

²⁵For detailed federal rulings and computation of taxable income, see *Income Tax Procedure*, 1921, pages 363-370.

Ratio of (b) for each year to (a) for each year for which cash is collected in current year applied to the collections in current year will give income to be reported as realized profits of current year.

Presumably the state in due course will amend article 34 above quoted to conform to the federal practice.

Some concerns did not choose to report on the instalment plan under the old federal rulings, which are similar to the present state rulings, because they felt that they would be taxed twice on the same profits, viz., those already reported on the old basis, and cash collections in the current period of accounts the profits on which were included in the preceding period.

In permitting instalment houses to report, in effect, profits only as collected, the Treasury has interpreted the law with a degree of liberality not extended to other cases, e. g., the taxing of exchanges of securities when nothing is realized in cash.

INCOME FROM THE SALE OF REAL ESTATE ON THE INSTALLMENT PLAN.—

REGULATION. Deferred payment sales of real estate ordinarily fall into two classes when considered with respect to the terms of sale, as follows:

(1) Installment transactions, in which the initial payment is relatively small (generally less than one-fourth of the purchase price) and the deferred payments usually numerous and of small amount. They include (a) sales where there is immediate transfer of title when a small initial payment is made, the seller being protected by a mortgage or other lien as to deferred payments, and (b) agreements of purchase and sale which contemplate that a conveyance is not to be made at the outset, but only after all or a substantial portion of the agreed installments have been paid.

(2) Deferred payment sales not on the installment plan, in which there is a substantial initial payment (ordinarily not less than one-fourth of the purchase price), deferred payments being secured by a mortgage or other lien. Such sales are distinguished from sales on the installment plan by the substantial character of the initial payment and also usually by a relatively small number of deferred payments.

In determining how these classes shall be treated in levying the income tax, the question in each case is whether the income to be reported for taxation shall be based only on amounts actually received in a taxable year, or on the entire consideration made up in part of agreements to pay in the future. (Art. 36.)

WHEN OBLIGATIONS OF PURCHASERS ARE NOT THE EQUIVALENT OF CASH.—

REGULATION. In the two kinds of transactions included in class (1) in the foregoing article, installment obligations assumed by the buyer are not ordinarily to be regarded as the equivalent of cash, and the vendor may report as his income from such transactions in any year that proportion of each payment actually received in that year which the gross profit to be realized when the property is paid for bears to the gross contract price. If the return is made on this basis and the vendor repossesses the property after default by the buyer, retaining the previous payments, the entire amount of such payments, less the profit previously returned, will be income to the vendor and will be so returned for the year in which the property was repossessed, and the property repossessed must be included in the inventory at its original cost to himself (less any depreciation as defined in articles 171 and 172). If the taxpayer chooses as a matter of settled practice consistently followed to treat the obligations of the purchaser as equivalent to cash and to report the profit derived from the entire consideration, cash and deferred payments, as income for the year when the sale is made, this is permissible. If so treated the rule prescribed in article 38 will apply.²⁶ (Art. 37.)

SALE OF REAL ESTATE IN LOTS.—

REGULATION. Where a tract of land is purchased with a view to dividing it into lots or parcels of ground to be sold as such, the entire fair market value as of January 1, 1919, or the cost, if acquired subsequent to that date, shall be equitably apportioned to the several lots or parcels and made a matter of record in the books of the taxpayer, to the end that any gain derived from the sale of any such lots or parcels may be returned as income for the year in which the sale was made. This rule contemplates that there will be a measure of gain or loss in every lot or parcel sold, and not that the capital invested in the entire tract shall be extinguished before any taxable income shall be returned. The sale of each lot or parcel will be treated as a separate transaction and the gain or loss will be accounted for accordingly. (Art. 35.)

²⁶See page 173.

WHEN OBLIGATIONS OF PURCHASERS ARE THE EQUIVALENT OF CASH.—

REGULATION. In class (2) in article 36 the obligations assumed by the buyer are much better secured because of the margin afforded by the substantial first payment, and experience shows that the greater number of such sales are eventually carried out according to their terms. These obligations for deferred payments are therefore to be regarded as equivalent to cash, and the profit indicated by the entire consideration is taxable income for the year in which the initial payment was made and the obligations assumed. If the buyer defaults and the seller regains title to the land by agreement or process of law, retaining payments previously made, he may deduct from his gross income as a loss in the year of repossession any excess of the amount previously reported as income over the amount actually received, and must include such real estate in his inventory at its original cost to himself (less any depreciation as defined in articles 171 and 172). (Art. 38.)

If notes accepted for the deferred payments cannot readily be discounted, such notes are not the equivalent of cash, and the sale should be treated as one on the deferred payment plan.

INSTALMENT BASIS NOT APPLICABLE TO ISOLATED TRANSACTIONS.—

REGULATION. The provisions of articles 34 to 38, both inclusive, are applicable only to transactions by taxpayers who regularly deal in personal or real property upon the installment or deferred payment plan. Isolated transactions are not within the scope of these provisions. (Art. 39.)

The above is directly contrary to the federal ruling,²⁷ which holds that the instalment method of reporting profits may be used "regardless of whether the sale is made by a dealer or other individual." The reason for the exclusion of isolated transactions is not apparent.

Replacement funds.—There is no provision in the state law or regulations, similar to that in the federal rulings,²⁸

²⁷Bulletin 18-20-894; Office Decision 482; see *Income Tax Procedure*, 1921.

²⁸Reg. 45, Art. 49; see *Income Tax Procedure*, 1921, pages 374-377.

permitting the establishment of a replacement fund when compensation is received for property lost through casualty or taken under the right of eminent domain which is temporarily not replaceable. The federal rulings in such cases permit the tax accounting to be postponed.

Recoveries for damages, patent infringement, bad debts, etc.—

REGULATION. Gains, profits and income are to be included in the gross income for the taxable year in which they are received by the taxpayer, unless they are included when they accrue to him in accordance with the approved method of accounting followed by him. Lands which are received as compensation for services in one year, the title to which is disputed and in a later year adjudged to be valid, constitute income to the grantee in the former year. On the other hand, a person may sue in one year on a pecuniary claim or for property, but money or property recovered on a judgment therefor rendered in a later year would be income in the year in which received assuming that it would have been income in the earlier year if then received. This is true of a recovery for patent infringement. Bad debts or accounts charged off because of the fact that they were determined to be worthless, which are subsequently recovered, whether or not by suit, constitute income for the year in which recovered, regardless of the date when the amounts were charged off. (Art. 44.)

In computing damages the element of value at January 1, 1919, must not be forgotten. In the case of damages for infringement of patents, etc., it is quite possible that suits not yet settled, or those which have been settled recently, include payments which properly apply to the period prior to January 1, 1919.

CHAPTER IX

INCOME FROM SALES, EXCHANGES AND APPRECIATIONS

As this book deals with procedure under an existing law, it is unnecessary to discuss the legality or propriety of taxing the gains or profits arising from the sale or exchange of property, including the profits from appreciation of property values. The taxation of profits derived from trading or dealing in commodities or securities or any other form of property has been discussed in Chapter VIII.

In this chapter the two outstanding points of importance are the determination of values at the date of the incidence of the tax (January 1, 1919) and the determination of "closed" transactions. Whether or not the realization of gains or profits from the sale of capital assets or investments is of the nature of income and therefore properly taxable under an income tax is an interesting problem and one not yet decided by our highest courts. Until the point is settled, all gains or profits are taxable.

In comparing federal with state practice it should be noted that under the state constitution there is no inhibition against the taxation of capital. Therefore, it may be decided by the Supreme Court of the United States that the sixteenth amendment to the federal Constitution is not broad enough to authorize Congress to tax gains realized from appreciation in value of capital assets, and at the same time such gains may be taxed by the state of New York.

In other words, under state practice the term "gains, profits and income" is probably broad enough to include all gains and profits, even though realized from the sale of capital assets. In the opinion of the author the sixteenth amendment to the federal Constitution also is broad enough to justify the taxa-

tion of capital gains. From the viewpoint of equity, there appears no good reason why capital gains should not be taxed so long as the method of taxation is equitable.

The federal method of taxing capital gains as income for the year when realized, even though the appreciation in value may have been accruing over a period of years, is inequitable; but it is a method which can easily be modified. Irrespective of federal action, the state of New York should amend the present law to permit the apportionment of gains over the period during which the appreciation in value can properly be deemed to have been accruing.

The taxation of imputed gains arising from the exchange of property for other property has been carried by the federal Treasury to an extreme not intended by the federal tax laws—an extreme which, in the opinion of the author, will not be upheld by the federal courts. Of course it is desirable that the federal and state practice should coincide so far as possible, but when the federal law is obviously misinterpreted there is no logical reason why the state authorities should blindly follow incorrect interpretations.

It may be expected that the state authorities will exercise independent judgment and will endeavor to interpret the state law in the light of reason instead of deciding against the taxpayer every point on which the slightest doubt appears.

Summary of Differences Between State and Federal Procedure

Since the state income tax law became effective January 1, 1919, profits from sale of property acquired prior to that date are based on the fair market value at January 1, 1919. The corresponding date for federal purposes is March 1, 1913.

There is no inhibition in the state Constitution against the taxation of capital gains, but a recent court decision has held that the sixteenth amendment to the federal Constitution is not broad enough to warrant taxing such gains as income.

On dissolution of a corporation, under the state law, only

the excess of the amount realized over the value of the stock at January 1, 1919, is taxable. Under the federal law, the undistributed surplus should first be distributed as a dividend free from normal tax. Only the excess of the balance over the fair market value of the shares on March 1, 1913, is taxable. (See page 185.)

The state regulations hold that the exchange of a convertible bond for stock having a market value results in a realization of profit or loss. This is the position formerly held by the federal authorities, but this regulation was amended in 1920 and now states that such an exchange does not result in a realization. The state, however, has not yet changed its position. (See page 187.)

Appreciation in value of a gift is taxed by the state to the donor, the state holding that the gift of property is such a "disposition" of it as may result in a profit. For example, a man owned securities which at January 1, 1919, were worth \$20,000. In December, 1920, he gave them to his son. At that time the fair market value was \$25,000. The state would tax the father on the \$5,000 appreciation in value. Under federal practice no attempt is made to tax such appreciation.

Income from Sales and Exchanges of Securities and Other Property

The state law and regulations follow in the main the federal procedure in that the taxable profit is measured by comparing the value of the property at the beginning of the period, or its cost if acquired after January 1, 1919, and the amount "received" therefor when sold for cash or when other disposition is made of it.

What Constitutes a Closed Transaction?¹

When an outright sale is made for cash no problem exists; but transactions vary by imperceptible degrees from the out-

¹For detailed discussion, see *Income Tax Procedure*, 1920, page 434 et seq.

right sale for cash through various sorts of trades and exchanges to the transaction in which the property is too indefinitely valued to afford a basis for claiming that a "realization" has been made. It is here that serious problems of procedure arise. When is a sale a true sale in the sense of being a closed transaction rather than merely a continuing one?

Criticism of the rulings.—The state has shown a disposition, by issuing numerous rulings of the same tenor as the federal regulations, to hold that many reorganizations are closed transactions and that a taxable profit has been realized. Even if securities are active on the exchanges the market values may be manipulated or temporary. In the case of reorganizations and exchanges, when there is a continuing interest in what broadly may be called the same property, to avoid injustice the tax should be levied only on those persons who actually realize on their securities. Those who hold and sell later should not be penalized. If they sell later at the market prices prevailing at the time of reorganization, the same tax will be paid—unless there is a change in the rate, and in that case the chances of its being substantially lower are not bright. If a greater profit is realized, a greater tax will be paid, and if a smaller profit is realized, a smaller tax will be paid; but this is as it should be and as the law intends. Not until the moment of an actual realization can an investor know the true outcome of the transaction. Up to that point no real gain, profit or income has accrued. Herein lies the chief difficulty in applying the inventory method to capital assets, because all inventory values are based upon estimates.

Here, as in the case of the federal tax, it is suggested that in any given instance the regulations be temporarily ignored and consideration be given to the question: "Does the transaction result in the receipt of income?" If it does we can proceed to determine the amount of the income which has been realized. If it does not, why bother with the regulations?

The following definition of income by Mr. Justice Pitney

of the United States Supreme Court² certainly does not comprehend many of the so-called gains arising from exchanges of property and securities or from gifts.

DECISION. After examining dictionaries in common use (Bouvier, L. D.; Standard Dict.; Century Dict.), we find little to add to the succinct definition adopted in two cases arising under the Corporation Tax Act of 1909 (*Stratton's Independence v. Howbert*, 231 U. S. 399, 415; *Doyle v. Mitchell Bros. Co.*, 247 U. S. 179, 185): "Income may be defined as the gain derived from capital, from labor, or from both combined," provided it be understood to include profit gained through a sale or conversion of capital assets, to which it was applied in the Doyle case (pp. 183, 185).

Brief as it is, it indicates the characteristic and distinguishing attribute of income essential for a correct solution of the present controversy. The government, although basing its argument upon the definition as quoted, placed chief emphasis upon the word "gain," which was extended to include a variety of meanings; while the significance of the next three words was either overlooked or misconceived. "*Derived-from-capital*," the "*gain-derived-from-capital*," etc. Here we have the essential matter: not a gain accruing to capital, not a growth or increment of value in the investment, but a gain, a profit, something of exchangeable value proceeding from the property, severed from the capital however invested or employed, and coming in, being "*derived*," that is, received or drawn by the recipient (the taxpayer) for his separate use, benefit and disposal; that is income derived from property. Nothing else answers the description.

. . . Secondly, and more important for present purposes, enrichment through increase in value of capital investment is not income in any proper meaning of the term.

Taxpayers are justified in relying on the foregoing decisions when determining income tax liability.

When sales are made for cash or equivalent.—A great deal could be written on the interpretation of the phrase "cash or equivalent," but practically the whole problem may be readily solved. If the securities or other property received consist of marketable securities, such as Liberty bonds, corporation bonds or stocks in which there is free trading in large lots on the New York or other prominent exchanges, no reasonable

²*Macomber v. Eisner*, 252 U. S. 189.

man can have difficulty in deciding on the exact value of the property received and reducing it to a cash basis.

If the property received consisted of unlisted stocks or bonds or real estate there would be greater difficulty, but in the majority of cases the vendor has definitely determined the value of the property to be received. He has placed a sales value on the property to be sold, even though such value was not disclosed to the other party to the transaction, and it may be inferred that the evidence on hand is sufficient to ascertain what may be regarded in his income tax return as the equivalent of cash.

The author feels very strongly that no transaction should be deemed to be closed unless there is an actual realization which can reasonably be looked upon as the equivalent of cash. On the other hand, it is only just to the government that when there is an exchange of one kind of property for an entirely different kind of property the recipient should not escape the tax merely because he refrains from converting what he receives into cash.

Basis when shares of same issue are bought and sold at different dates.—The state has issued a regulation identical with the federal ruling³ requiring that sales must be charged against the earliest purchases instead of an average cost, when particular lots cannot be identified.

REGULATION. When shares of stock in a corporation are sold from lots purchased at different times and at different prices and the identity of the lots cannot be determined, the stock sold shall be charged against the earliest purchase of such stock. The excess of the amount realized on the sale over the cost of the stock, or its fair market value as of January 1, 1919, if purchased before that date, will be the profit to be accounted for as income. . . . (Art. 31.)

The theory of this regulation is wrong. When different purchases of the same issue of stock are made, the actual result is an average cost. When a taxpayer buys 100 shares of

³Reg. 45, Art. 39.

a stock at 80 and later buys 100 shares at 60, he owns 200 shares at 70 and any subsequent accounting should be based on the average. There are difficulties in the application of the average rule when the certificates for the shares can be identified, because there may be an actual intention on the part of the taxpayer to separate the transactions. Even here the right to select the certificates to be sold is used by some taxpayers to evade the intention of the law even though they follow the regulations. A taxpayer holding 100 shares of stock, which cost him 50 and is freely selling at 100, desires to sell but does not wish to pay the tax on the profit. He retains his original certificate and sells 100 shares "short." He claims that he has two continuing transactions and makes no return. In such cases the author has advised that the original stock should be returned as having been sold, as that is the way the transaction would be recorded in any accounts kept according to recognized accounting principles.

When sale is made on instalment plan can tax be deferred?

—In view of the rulings⁴ applicable to instalment houses, taxpayers need not consider that notes and other securities received for property sold on instalment basis are the equivalent of cash unless they can readily be discounted at a reasonable rate of interest.

Purchase of assets by bondholders.—It frequently happens that bondholders, in order to protect themselves, purchase outright the property represented by their bonds or exchange their bonds for stock in a reorganized company which purchases the assets of the old corporation.

The author is of the opinion that in such cases, a closed transaction usually results, upon which gain or loss should be computed. The old stockholders lose their rights and the bondholders become stockholders. They change their status

⁴See page 169 *et seq.*

as creditors to that of owners. The new value at which the property is taken over by the new corporation will be the basis for computing the profit or loss on account of the exchange.

Lease of property to foreign corporation.—In a recent case⁵ the court held that a domestic corporation could not lease its property to a foreign corporation on the ground that the law of the state did not permit such a lease, but in the decision said that the purpose to be accomplished was to save a large sum in taxes and that it is the duty of the court in such circumstances to look through the form.

Assuming that the laws of the state do not prohibit the making of such a lease, the author is of the opinion that such an arrangement is not improper.

Proceeds of sale of goodwill are taxable.—The position of the state with regard to computing profit on the sale of goodwill is the same as the federal law, except that January 1, 1919, instead of March 1, 1913, is the basic date when the goodwill was acquired prior to the incidence of the tax.

REGULATION. Any profit or loss resulting from an investment in good will can be taken only when the business, or a part of it, to which the good will attaches is sold, in which case the profit or loss will be determined upon the basis of the cost of the assets, including good will, or their fair market value as of January 1, 1919, if acquired prior thereto. If nothing was paid for good will acquired on or after January 1, 1919, no deductible loss is possible, although, on the other hand, upon the sale of the business there may be a profit. It is immaterial that good will may never have been carried on the books as an asset, but the burden of proof is on the taxpayer to establish the cost or fair market value on January 1, 1919, of the good will sold. (Art. 33.)

If an individual sells his business to a corporation for its stock it can hardly be expected that the stock received will be worth par value. Goodwill usually is valued on a hoped-for

⁵*Allen v. The Francisco Sugar Co.*, 110 Atl. 37.

basis. Hopes are not taxable subjects. If he sells to others, under the regulations he will be required to account for the fair value of the stock he receives. If he incorporates his own business he cannot be charged with receiving something he did not have before.

Profits on sale of rights to subscribe to stock held to be taxable.—

REGULATION. . . . The entire amount realized from the sale of rights to subscribe for stock by a stockholder to whom such rights are issued, is income. (Art. 31.)

Unlike the federal ruling,⁶ the foregoing limits the taxation of the entire proceeds of the rights to "the stockholder to whom such rights are issued." In other words, a purchaser of rights who resold them would be taxable only on the excess of selling price over cost to him. As to the stockholder to whom the rights are issued, this regulation is too broad. In some cases its application accomplishes substantial justice, but, on the other hand, there are numerous instances in which the issuance of the rights operates to depreciate the value of the remaining shares. When this is true, the realization from the sale of rights is certainly not all gain or profit. The principle involved is very much the same as that which governs stock dividends.⁷ In some cases the courts have held the proceeds of sales of rights to be wholly capital. In view of the recent stock dividend case,⁸ it would appear that article 31 should be modified to provide for cases wherein the original shares are depreciated by the issuance of rights.

Is an option taxable?—It may be claimed that if an option is not exercised no profit can accrue, and that so long as the option has not been exercised there has been no realization and it is not a closed transaction as defined by the regulations. The

⁶Reg. 45, Art. 39.

⁷See page 258 *et seq.*

⁸*Macomber v. Eisner*, 252 U. S. 189.

case is somewhat analogous to the receipt, as the proceeds of a sale, of a Liberty bond or currency, which later was lost or stolen. The proceeds or gain of the sale would never be realized in the sense of any permanent advantage to the taxpayer. He had the cash, but he lost it; and he had the option, which he might have sold, but did not.

Therefore, if an option can freely be sold at the date of receipt, it is probable that it will be taxed. Most options, however, cannot be deemed to be the equivalent of cash, and the exercise thereof constitutes a continuing rather than a closed transaction.

Reorganizations, Mergers and Consolidations

The provisions of the state law⁹ are similar to the federal law,¹⁰ in that in general when property is exchanged for other property, the property received "shall be treated as the equivalent of cash to the amount of its fair market value, if any," but that a transaction shall be considered a continuing one rather than a closed and completed one, first, "when in connection with the reorganization, merger or consolidation of a corporation a taxpayer receives in place of stock or securities owned by him new stock or securities of no greater aggregate par or face value," second, when there is no fair market value of the new securities, and, third, to a limited extent when the aggregate face value of the securities received is in excess of the face value of the securities exchanged.

The law thus places a premium upon those reorganizations, mergers and consolidations that otherwise might be held to be closed transactions, in which payment is made for securities on a basis of the same or smaller par value. In such cases no return whatever is required even though there be an actual or market value of the new shares which is several times the par value.

When the aggregate par value of the securities received

⁹Section 354.

¹⁰Federal law, section 202 (b).

is in excess of the par value of the securities exchanged, the law apparently intends that to some extent the transaction may be regarded as a continuing one. It would seem that the taxable profit in any event would not exceed the difference between the par value of the securities exchanged and the par value of the new securities, even though the difference in par value were less than the gain would be if calculated on the basis of the difference between the fair market value of the new securities and the cost or value January 1, 1919, of the old securities. In other words, if the par value of new securities is \$100,000 greater than the par value of the old, and the market value of the new is \$200,000 greater than the cost, or January 1, 1919, value of the old, the tax will be imposed only on the \$100,000, because that is the lower of the two.¹¹

Disposition of surplus of dissolved corporation.—Taxpayers who receive cash or securities arising from the dissolution of a corporation should inquire as to whether or not the old corporation had an undistributed surplus account on its books. If so, such surplus as and when distributed to stockholders in dividends is taxable under the state law. When distributed in dissolution, and not as a dividend only, the difference between the value of the stock at January 1, 1919, and the amount realized would be taxable. So long as the federal rates are higher than the state rates, it is usually more beneficial to stockholders to distribute accumulated surplus as regular dividends than as a distribution in dissolution.

Dissolved corporation succeeded by partnership.—When there is in effect a mere change in form in conducting the business, the stockholders of the old corporation continuing as a partnership, it is not likely that the courts would hold that income is realized and uphold a ruling like the following in which the Comptroller holds such a case to be a closed transaction.

¹¹Art. 100, page 192.

RULING. In the case of a corporation organized in 1918 which dissolved and was taken over by a partnership consisting of the stockholders of the corporation, what would be the gain or loss on this transfer when the whole transaction occurred in the year 1920?

The valuation of the shares of stock of the corporation as of January 1, 1919, must be determined by their fair market value on that date. Gain or loss on the transferring of those shares for the interest in the partnership, will be determined by the difference in value between the partnership interest received and the value on January 1, 1919, of the shares of stock disposed of. (Question 107, Comptroller's Questions and Answers, 1921.)

Exchanges Which Are Taxable as Closed Transactions¹²

The state law, like the federal law,¹³ requires an accounting for property received for other property under certain conditions.

LAW. Section 354. When property is exchanged for other property, the property received in exchange shall for the purpose of determining gain or loss be treated as the equivalent of cash to the amount of its fair market value, if any;

In dealing with exchanges of stock, it has been the federal practice to consider the different corporations as separate entities, and the state will probably follow the federal interpretations until the courts pass upon the questions involved, since the state law and regulations in the main are the same as the federal on this subject.

The courts, however, in some cases, have refused to recognize that a taxable profit arises in transactions between corporations which occur "as a matter of form and of book-keeping."¹⁴

The state regulation dealing with the general principles for determining loss or gain is identical with the federal ruling before amendment in 1920. The last sentence in the present state regulation has been amended in the federal ruling so that the exchange of a convertible bond for stock having a market

¹²For detailed rulings and illustrations under the federal practice, see *Income Tax Procedure*, 1921, page 457 et seq.

¹³Section 202 (b).

¹⁴*Alpha Portland Cement Co. v. U. S.*, 261 Fed. 339, quoted in full in Appendix B.

value does *not* "result in a realization," indicating that the federal authorities are revising their restricted view of what constitutes a closed transaction.

REGULATION. Gain or loss arising from the acquisition and subsequent disposition of property is realized when as the result of a transaction between the owner and another person the property is converted into cash or into property (a) that is essentially different from the property disposed of and (b) that has a market value. In other words, both (a) a change in substance and not merely in form, and (b) a change into the equivalent of cash, are required to complete or close a transaction from which income may be realized. By way of illustration, if a man owning ten shares of listed stock exchanges his stock certificate for a voting trust certificate, no income is realized, because the conversion is merely in form; or if he exchanges his stock for stock in a small, closely held corporation, no income is realized if the new stock has no market value, although the conversion is more than formal; but if he exchanges his stock for a liberty bond, income may be realized, because the conversion is into independent property having a market value.¹⁵ The property received in exchange may be real estate, personal property, or a chose in action. The exchange of a so-called convertible bond for stock pursuant to such a privilege granted in the bond will produce income if the stock received in exchange has a fair market value in excess of the cost or fair market value as of January 1, 1919, of the bond. (Art. 94.)

It is true that article 1563 states that the property received may be real or personal property or a chose in action, but unless there can be ascribed to what is received "fair market value" the property received need not be valued at the time of exchange. Roughly speaking, a chose in action is an account receivable, contract, agreement, option or similar undertak-

¹⁵Reg. 45, Art. 1563, reads exactly like the foregoing. By amendment in February, 1920, the following was added at this point:

"'Market value' is the price at which a seller willing to sell at a fair price and a buyer willing to buy at a fair price, both having reasonable knowledge of the facts, will trade. Property received in exchange for other property has no 'fair market value' for the purpose of determining gain or loss resulting from such exchange when, owing to the condition of the market, there can be no reasonable expectation that the owner of the property, though wishing to sell and any person wishing to buy will agree upon a price at which to trade unless one or the other is under some peculiar compulsion. It does not follow that property has no 'fair market value' merely because there is no price therefor established by public sales or sales in the way of ordinary business."

ing upon which a suit at law can be maintained. If it has a market value, as options frequently have, it will be taxable.

Meaning of "fair market value" as used in law [section 354].—It is too early in the administration of the state law to expect rulings in specific cases on what is fair market value, but the federal rulings have treated this subject at great length, so that the test (in theory rather than in practice) may now be said to be: (1) there must be a willing seller and a willing buyer; and (2) there must be an *actual* market. As to (1) the rule is well stated in the recently amended federal regulation:¹⁶

"Market value" is the price at which a seller willing to sell at a fair price and a buyer willing to buy at a fair price, both having reasonable knowledge of the facts, will trade.

As to the second condition, the federal rulings have attempted to impute a value when there was no actual market, but the state will hardly follow such erroneous procedure, since the law is quite clear and provides that "the property received in exchange shall . . . be treated as the equivalent of cash to the amount of its fair market value, *if any*." (The italics are the author's.)

Does the sale of less than control constitute a closed transaction?—The state has issued no specific ruling for cases in which the sale of property does not involve changing control. The federal ruling¹⁷ which first held that when an interest of 50 per cent. remained in the same owners "no gain or loss is realized," was revoked, although it is clear that no actual sale takes place when the owner of property changes its form to some extent and perhaps sells a minority interest therein, but at the same time retains control. There are, however, cases in which new interests are brought into a new corporation and

¹⁶Reg. 45, Art. 1563, was amended in February, 1920, to include the definition of "market value."

¹⁷Reg. 45, Art. 1566.

various changes take place which justify dealing with the matter as a closed transaction. In such cases no injustice is done to the former owners, as they are responsible for the events.

Such exceptions in no way modify the general rule that no taxpayer should be taxed upon supposed income when he is able to produce evidence that actual income has not been realized by him.

Exchanges of property for stock.—The following state regulation sets forth a general rule for determining whether gain or loss results from the exchange of property for stock. It is similar to the federal ruling, excepting that the state regulation does not contain the words “if the stock has a market value.” It may be assumed, however, that the term “market value” will be reasonably construed and that market value will not be imputed to the stock of a closely held corporation; nor should the sale of a few shares or a minority interest be deemed to create a market value for the entire issue. The test will continue to be: “Has income been realized?”

REGULATION. Where property is transferred to a corporation in exchange for its stock, the exchange constitutes a closed transaction and the former owner of the property realizes a gain or loss if the fair market value of the stock is greater or less than the cost or the fair market value as of January 1, 1919 (if acquired prior thereto), of the property given in exchange. . . . (Art. 97.)

Exchanges of stocks of subsidiary corporations for stocks of holding corporations.—The state, like the federal, regulations hold that cases of “readjustment” in which stock is exchanged for stock of a holding corporation are to be regarded as “reorganizations.” Under the federal ruling,¹⁸ however, the affiliation must be so close as to be one calling for consolidated returns.

REGULATION. . . . The term “reorganization,” as used in section 354 of the statute, includes cases of corporate readjustment where

¹⁸Reg. 45, Art. 1567, as amended by T. D. 2924.

stockholders exchange their stock for the stock of a holding corporation, provided the holding corporation and the original corporation, in which it holds stock, are closely related and affiliated. . . . (Art. 98.)

The foregoing regulation is intended to bring holding company readjustments under the reorganization provisions of the law. Until the law is more liberally interpreted, care should be taken to limit the par value of the stock of holding companies exchanged for the stock of subsidiary corporations.

Income from exchange of stocks for bonds.—

REGULATION. (a) The amount of income derived in the case of an exchange of property, as of stock for a bond, is the excess of the fair market value at the time of exchange of the bond received in exchange over the original cost of the stock exchanged for it, or over the fair market price or value of such stock as of January 1, 1919, if acquired before that date. The amount of income derived from a subsequent sale of the bond for cash is the excess of the amount so received over the fair market value of such bond when acquired in exchange for the stock. . . . (Art. 95.)

The foregoing regulation is identical with the federal ruling,¹⁹ excepting that the state measures value from January 1, 1919, instead of March 1, 1913, for securities acquired prior to incidence of the tax.

As a bond represents a debt or liability of the issuing corporation and stock is not a liability, there may be a change in substance as well as in form. If the exchange is for preferred stock it probably would not be taxable. In no case would the transaction be taxable unless a fair market existed for the new securities.

Exchanges of property for stock and bonds.—

REGULATION. (a) If property is exchanged for two different kinds of property, such as bonds and stock, the bonds having a market value and the stock none, the value of the bonds is to be compared with the cost or fair market value as of January 1, 1919, of the original property, as the case may be. If the market value of the

¹⁹Reg. 45, Art. 1564.

bonds is less than such cost or value, the difference represents the cost of the stock. If the market value of the bonds is greater than such cost or value, the difference is taxable income at the time of the exchange and whenever sold the entire proceeds of the stock will be taxable. (b) If property is exchanged for two different kinds of property, such as bonds and stock, neither having a market value, the cost or fair market value as of January 1, 1919, of the original property should be apportioned if possible, between the bonds and stock for the purpose of determining gain or loss on subsequent sales. . . . (Art. 96.)

When the owner receives cash as well as bonds for his former holdings or when new cash is invested by others, the bonds received represent a change in substance as well as in form.

When greater aggregate par value of securities is received in exchange.—A new section of the federal law,²⁰ added in 1918, is found almost word for word in the state law. It deals with transactions in which the par value of securities received exceeds the par value of the old securities.

LAW. Section 355. When in the case of any such reorganization, merger or consolidation the aggregate par or face value of the new stock or securities received is in excess of the aggregate par or face value of the stock or securities exchanged, a like amount in par or face value of the new stock or securities received shall be treated as taking the place of the stock or securities exchanged, and the amount of the excess in par or face value shall be treated as a gain to the extent that the fair market value of the new stock or securities is greater than the cost of the stock or securities exchanged, if acquired on or after January first, nineteen hundred and nineteen, and its fair market price or value as of January first, nineteen hundred and nineteen, if acquired before that date.

The foregoing section of the law, like that of the federal provision, attempts, as a maximum, to impose a tax upon the *excess* of the par value of the new securities over the aggregate par of the old.

The part of the section dealing with the excess of par value has been interpreted to mean that in no case shall the gain

²⁰Federal law, section 202 (b).

upon which the former owner is to be taxed exceed the amount by which the aggregate new par exceeds the aggregate old par. If stock having par of \$10,000 (the fair market value of which on January 1, 1919, was \$10,000) is exchanged for stock having new par of \$100,000 (fair market value \$1,000,000), the gain is deemed to be \$90,000 and not \$990,000.

But if stock having par of \$100,000 (the fair market value of which on January 1, 1919, was \$150,000) is exchanged for new stock having par of \$200,000 (the fair market value being \$200,000) the gain is deemed to be \$50,000 and not \$100,000.

The state regulation confirming the foregoing interpretation is identical with the federal ruling,²¹ excepting that the date January 1, 1919, is used in place of March 1, 1913.

REGULATION. If in the case of any reorganization, merger or consolidation the aggregate par or face value of the new stock or securities received is in excess of the aggregate par or face value of the stock and securities exchanged, income will be realized from the transaction by the recipients of the new stock or securities to an amount limited by (a) the excess of the par or face value of the new stock or securities over the par or face value of the old and (b) the excess of the fair market value of the new stock or securities over the cost or fair market value as of January 1, 1919, of the old. In other words, the taxable profit will be (a) or (b) whichever is less. Upon a subsequent sale of the new stock or securities their cost to the taxpayer will be the cost or fair market value as of January 1, 1919, of the old stock and securities, plus the profit taxed on the exchange. (Art. 100.)

"Stock or securities" defined.—Under the federal practice²² it has been held that the expression "stock *or* securities" is equivalent to "stock *and* securities," so that if the par of both stock and securities received, taken together, does not exceed the par of stock and securities exchanged, there is no taxable profit.

²¹Reg. 45, Art. 1569.

²²*Income Tax Procedure*, 1921, page 473.

Does the term "aggregate par or face value" exclude from the computation "no-par" value stock?—

LAW. Section 354. . . . But when in connection with the reorganization, merger or consolidation of a corporation a taxpayer receives, in place of stock or securities owned by him, new stock or securities of no greater aggregate par or face value, no gain or loss shall be deemed to occur from the exchange, ...

The above section of the state law differs from the similar federal provision²³ in that the word "taxpayer" is used in place of "person." This is so because under the state law corporations are not subject to income tax, but they are subject to income tax under the federal law.

The state has issued a regulation which is identical with the federal ruling²⁴ as to "no-par" stock.

REGULATION. . . . So-called "no-par-value stock" issued under a statute or statutes which require the corporation to fix in a certificate or on its books of account or otherwise an amount of capital or an amount of stock issued which may not be impaired by the distribution of dividends, will for the purpose of this section be deemed to have a par value representing an aliquot part of such amount, proper account being taken of any preferred stock issued with a preference as to principal. In the case (if any) in which no such amount of capital or issued stock is so required, "no-par-value stock" received in exchange will be regarded for purposes of this section as having in fact no par or face value, and consequently as having "no greater aggregate par or face value" than the stock or securities exchanged therefor. (Art. 98.)

In the original edition of federal Regulations 45, the article corresponding to the foregoing read: "If the stock so received has no nominal or par value the limitation on the aggregate par value is inapplicable." This was intended and accepted as a reasonable interpretation of the law.

Can the equivalent of "par" value be imputed to "no-par" value stock?—In the only ruling issued by the state dealing with a specific case, it would appear that the state also intends

²³Section 202 (b).

²⁴Reg. 45, Art. 1567.

to impute "par value" to "no-par-value" stock. New York is one of the states requiring a corporation to state the "amount of capital with which it will carry on business" and no-par stock must be valued at \$5 a share at least. But the following ruling in regard to an exchange of par-value stock for no-par stock states a very important principle, viz.: "The holder of the old stock will possess nothing after the reorganization which he did not have before." It is upon the same principle that the author has based his arguments against taxing profits in reorganizations when there are no profits excepting "paper" profits or when there is a mere rearrangement of securities.

RULING. It appears from your letter of recent date that a corporation has outstanding 10,000 shares of common stock of a par value of \$100 each, making an authorized capitalization of \$1,000,000. The corporation has \$5,000,000 in assets and now intends to reorganize issuing 200,000 shares of no par value stock and to issue and sell \$4,000,000 of preferred stock. Each holder of a \$100 par value share will receive in exchange 20 shares of no par value under the reorganization plan.

Your question is this: Does the \$4,000,000 of assets operate to add to the face value of the no par stock five times its intended value because the \$4,000,000 is placed in the stated capital to cover the preferred stock authorized? In other words, is the value of the no par stock equal to the total amount of capital and surplus when there has been no increase in the value of the holdings, each present holder of common stock thereby realizing income taxable under the New York State Income Tax Law.

Article 98 of the Regulations provides:

"So-called "no par value stock" issued under a statute or statutes, which require the corporation to fix in a certificate or on its books of account or otherwise an amount of capital or an amount of stock issued which may not be impaired by the distribution of dividends, will for the purpose of this section be deemed to have a par value representing an aliquot part of such amount, proper account being taken of any preferred stock issued with a preference as to principal."

Sections 19 and 24 of the Stock Corporation Law provide:

"In the certificate of reorganization a corporation must state the amount of capital with which it will carry on business, which amount shall not be less than the amount of the preferred stock authorized to be issued, and in addition a sum equivalent to \$5.00 for every share other than preferred stock."

Section 23 of the Stock Corporation Law provides in part as follows:

"The aggregate amount of the capital stock of any such corporation formed pursuant to Section 19 hereof shall be deemed to be the aggregate amount specified in the certificate or amended certificate of incorporation or reorganization as the amount of capital with which the corporation will carry on business; the amount of the par value of each share of preferred stock having a preference as to principal shall be deemed to be the amount thereof so specified in such certificate or such amended certificate; and the amount or the par value of each other share shall be deemed to be an aliquot part of the aggregate capital so specified in such certificate or in such amended certificate in excess of the specified amount (if any) of the preferred stock therein authorized to be issued with a preference as to principal."

The above provisions of the law are clear and explicit. The value of no par stock is determined by the amount of capital attributed to it. In the case at hand \$1,000,000 of capital is to cover the issue of 200,000 shares of stock of no par value to be exchanged for the outstanding 10,000 shares of \$100 par value stock. Each holder of the one share of the latter will receive in exchange 20 shares of the former. It is difficult to see wherein the holders of old stock derive any gain or profit by reason of such an exchange. While the entire surplus of \$4,000,000 is to be capitalized, it is covered by the preferred stock to the amount of \$4,000,000. Therefore, in computing the value of the no par stock, the value of the preferred must be considered. The holder of old stock will possess nothing after the reorganization which he did not have before. Since the United States Supreme Court has held that the receipt of a stock dividend does not constitute a realization of income, it would seem consistent to apply the same principle to this case.

It is therefore concluded that the exchange by any stockholder of one share of old stock for 20 shares of new stock of no par value under the reorganization plan outlined above will not be considered as construing the receipt by him of taxable income under the New York Income Tax Law. (Official ruling, dated July 10, 1920.)

Effect of the receipt of cash (or property other than cash) by former owners.—When the owner of stock having a par value of \$100,000 exchanges it for \$100,000 in cash and 10,000 shares (or any number) of no-par value stock of a new corporation, under a proper interpretation of the law no tax can be imposed, because the former owner has not received securities of a greater aggregate par or face value.

But if the former owner were to receive \$200,000 in cash and 10,000 new shares (or any other number) of no-par value, it could not be said that he received in exchange securities of no greater aggregate par value.

New securities "of no greater par value" must cover the same property as the old securities.—Section 354 refers definitely to the "reorganization, merger or consolidation of a corporation," as does the similar provision of the federal statute.²⁵ It is not implied that the stock of a different corporation may be brought within the temporary freedom from tax, when there is an exchange of marketable securities of various corporations for the stock of an entirely different corporation.

Exchange of securities for new securities of foreign corporation of no greater par value and subsequent sale of latter at profit.—It has been suggested that one way of avoiding the immediate imposition of a tax, when securities are in effect exchanged for securities of greater par value, is to exchange the old stock for a like amount of par-value stock of a foreign corporation (Cuban, for illustration) doing no business and having no office or agent in the United States. Under section 354 it is not likely that any tax could be imposed upon such exchange.

The way is then open for the foreign corporation to exchange or sell the stock so acquired or to sell the property represented by the stock. The sale or exchange may be for cash or securities of unlimited par value. The profit, if any, will be taxable only to the foreign corporation. The United States corporation retains its ownership of the shares of the foreign corporation, but unless and until the foreign corporation pays a dividend or makes a distribution, no taxable income will be realized. If it were possible to pass a law requiring the stockholders of the foreign corporation who are citizens of or residing in the United States to cause the foreign cor-

²⁵Federal law, section 202 (b).

poration to pay a dividend or make a distribution the realized profit might be reached.

As corporations are not subject to state income tax the state law has no such provision as section 220 of the federal law by which undistributed profits of corporations may be reached by subjecting the stockholders to surtax on such amounts not distributed.

When securities received are of less aggregate par value.—

When new securities have smaller aggregate par value than old securities, of course, under the law no tax can be assessed, neither can a loss be claimed unless an actual loss is established. The new securities may be worth far more than par. If a loss is claimed it will have to be shown that the actual fair market value of the new securities is less than the cost (or fair market value January 1, 1919) of the old securities, and it must be a realized loss.

Sale of capital assets by a corporation.—When a corporation sells its assets for an amount in excess of their book value the corporation will be taxed under the federal law on the excess. In turn the stockholders, when distribution is made, will be taxed again under both federal and state laws. In order to avoid this double taxation the individual stockholders of the selling corporation should sell their stock to the new owner. When the purchaser acquires all the stock he or it may cause all the assets of the corporation to be turned over for a nominal consideration. Thus the books of the corporation will not show any profit on the sale.

Exchanges Which Are Not Taxable as Closed Transactions

As previously stated, the state law is identical with the federal provision relative to exchanges, excepting that the word "taxpayer" is substituted for "person" as corporations are not subject to state income tax.

LAW. Section 354. . . . but when in connection with the reorganization, merger or consolidation of a corporation a taxpayer receives, in place of stock or securities owned by him, new stock or securities of no greater aggregate par or face value, no gain or loss shall be deemed to occur from the exchange, and the new stock or securities received shall be treated as taking the place of the stock, securities or property exchanged.

The following regulations are identical with the federal rulings.²⁶

REGULATIONS (b) On the other hand, if the property received in exchange is substantially the same property or has no market value, then no gain or loss is realized, but the new property is to be regarded as substituted for the old and upon a sale of the new property the amount of income derived is the excess of the amount so received over the cost or fair market value as of January 1, 1919, of the old. (Art. 95.)

. . . . If no fair apportionment is practicable, no profit on any subsequent sale of any part of the bonds or stock is realized until out of the proceeds of sale there shall have been recovered the entire cost or fair market value as of January 1, 1919, of the original property. (Art. 96.)

The basic question involved is: Does the exchange *actually* constitute a closed transaction and *does* the former owner realize any taxable income? And the answer made to this question in the state's official ruling, dated July 10, 1920, asserts what is true in the case of many reorganizations, viz.: "It is difficult to see wherein the holders of old stock derive any gain or profit by reason of such an exchange."

The following regulation, which is identical with the federal ruling²⁷ indicates clearly that no income is deemed to accrue so long as the aggregate par value of the securities received does not exceed the aggregate par value of the old securities.

REGULATION. In general, where two (or more) corporations unite their properties by either (a) the dissolution of corporation B and the sale of its assets to corporation A, or (b) the sale of its property by B to A and the dissolution of B, or (c) the sale of the

²⁶Reg. 45, Arts. 1564, 1565.

²⁷Reg. 45, Art. 1567.

stock of B to A and the dissolution of B, or (d) the merger of B into A or (e) the consolidation of the corporations, no taxable income is received from the transaction by A or B or the stockholders of either, provided the sole consideration received by B and its stockholders in (a), (b), (c) and (d) is stock or securities of A, and by A and B and their stockholders in (e) is stock or securities of the consolidated corporation, in any case of no greater aggregate par or face value than the old stock and securities surrendered. . . (Art. 98.)

Determination of gain or loss from subsequent sale.—

When the exchange of securities is regarded as a continuing transaction, no income is reported. But upon any subsequent sale or realization the computation of taxable income is based on the original cost of the old securities or value January 1, 1919, and not on the value of the securities at the date of the exchange.

REGULATION. The new stock and securities received as described in the preceding article take the place of the old stock and securities. For the purpose, therefore, of ascertaining the gain derived or loss sustained from the subsequent sale of any stock or securities so received, the original cost to the taxpayer or the fair market value as of January 1, 1919, of the stock or securities in respect of which the new stock and securities were issued, less any untaxed distribution made to the taxpayer by A out of the former capital or surplus of B, or by the consolidated corporation out of the former capital or surplus of A or B, is the basis for determining the amount of such gain or loss. (Art. 99.)

The foregoing regulation is similar to the federal ruling before the Treasury amended it by T. D. 2963, early in 1920. The federal ruling as amended allocates the old cost to the new securities in the proportion that the market value of each class of new securities bears to total market value at date of exchange.²⁸

²⁸The amendment to Reg. 45, Art. 1568, referred to, reads in part:

"When securities of a single class are exchanged for new securities of the same total par value but of different classes, for purposes of determining profit or loss on subsequent sale of any of the new securities, the proportion of original cost (or value as of March 1, 1913) to be allocated to each class of new securities is that proportion which the market value of the particular class bears to the market value of all securities received on the date of the exchange. For example, if 100 shares of common stock par value \$100 are exchanged for 50 shares of preferred and 50 shares

Inventory system as applied to conversion or rearrangement of securities.—No general rule as to conversion or rearrangement of securities can be laid down, other than that mentioned in cases fully discussed in the preceding pages, viz.: a continued investment in the same corporation, when there has been only a partial or no realization of cash, should not be termed a closed or completed transaction and no tax should accrue thereon until a realization shall have taken place. If the taxpayer desires and should in the future be permitted to report on the accrual or inventory system and the new securities indicate an increase in value, a return thereof may be the most equitable way of dealing with the case.

Income Derived from Sale of Property Acquired by Gift and Inheritance

REGULATION. In the case of property acquired by gift, bequest, devise or descent the basis for computing gain or loss on a sale is the fair market price or value of the property at the date of acquisition or as of January 1, 1919, if acquired prior thereto. For the purpose of determining the profit or loss from the sale of property acquired by bequest, devise, or descent since December 31, 1918, its value as appraised for the purpose of the New York transfer tax, or in the case of estates not subject to that tax its value as appraised in a State court for the purpose of State inheritance tax, should be deemed to be its fair market value when acquired. If there has been no judicial determination of the fair market value as of the date of acquisition, such value is a matter of fact to be proved by the taxpayer. (Art. 93.)

The foregoing is similar to the federal regulation, excepting that the dates January 1, 1919, and December 31, 1918,

of common each of \$100 par value, and the cost of the old stock was \$250 per share, or \$25,000, but the market value of the preferred on the date of exchange was \$110 per share, or \$5,500 for the 50 shares, and the market value of the common was \$440 per share, or \$22,000 for the 50 shares of common, one-fifth of the original cost, or \$5,000, would be regarded as the cost of the preferred and four-fifths, or \$20,000, as the cost of the common. Similarly, the cost after reorganization, merger, or consolidation of the assets of A or of the consolidated corporation is the sum of the cost (or the fair market value as of March 1, 1913) of the assets of A and of B for the purpose of ascertaining the gain or loss upon a subsequent sale."

respectively, are used instead of the corresponding dates under the federal rulings, March 1, 1913, and February 28, 1913. The state requires use of the appraisals of state courts, while the federal ruling prescribes the use of appraisals made for purpose of the federal inheritance tax.

In certain cases, however, these appraisals are not representative of true values and cannot be used as indicated. When the state or federal appraisals are unimportant, as when no substantial tax depends thereon, nominal values may have been used and these nominal values cannot be deemed to be fair market values.

If the recipient of a gift disposes of it during his lifetime he must report as taxable income (if a profit be realized) the difference between the value of the gift on the day it was received, or if it was received before January 1, 1919, its value on that date and the amount realized. If the proceeds of the sale are less than the value on the date of receipt or on January 1, 1919, the resulting loss is an allowable deduction.

No income tax is imposed upon an estate for appreciation in values which may exist at the date of death, but inheritance taxes are supposed to be based on actual values.

Appreciation in value of gift held to be income to donor.—

REGULATION. . . . Where the gift is other than money, the basis for calculation of the amount of the gift shall be the fair market value of the property at the time given, but the difference between such value and cost (or fair market value on January 1, 1919, if acquired before that date) shall be returned as profit or loss by the donor. . . . (Art. 201.)

The state is attempting to tax to the donor appreciation in value of gifts on the theory that the words "sale or other disposition of property" are sufficiently inclusive to mean that a gift is such "other disposition of property" as to constitute a closed transaction in which a taxable profit is realized.

Assume that a man makes his wife a gift of stock costing \$1,000 in 1910; fair market value at date of gift was \$15,000;

fair market value at March 1, 1913, was \$5,000; fair market value January 1, 1919, was \$10,000. Under the federal law there is no tax. .

REGULATION. . . . Gifts, whether charitable contributions or otherwise, constitute a disposition of property which may result in a profit or loss to be measured by the difference between the cost (or the value on January 1, 1919, if acquired prior thereto) and the value at the date of the gift. (Art. 91.)

Under the foregoing state regulation it would seem that there should be returned for taxation \$5,000, that being the difference between value at January 1, 1919, and the value at the date of the gift. The state law, however, taxes only "gains, profits and income," and in the opinion of the author no taxable income arises from a gift and no tax can be imposed unless and until the law is amended to require the inventory of appreciation in values. (For discussion of appreciation of property values, see *Income Tax Procedure*, 1921, page 394.)

In a recent ruling, the state's determination to tax such appreciation is reiterated.

RULING. If a father, on account of affections, gave certain securities to his son, is the father required to report as income the appreciated value of such property at the time of disposal?

Yes. Article 201 of the Comptroller's Regulations provides as follows: "Where a gift is other than money, the basis of calculation of the amount of the gift shall be the fair market value of the property at the time given, but the difference between such value and cost (or fair market value on January 1, 1919, if acquired before that date) shall be returned as profit or loss by the donor." (Question 19, Comptroller's Questions and Answers, 1921.)

The federal government has not attempted to tax such so-called income, but, as heretofore explained, state taxation is not limited as is taxation under the federal Constitution.

The following discussion²⁹ is of interest as setting forth the views of Mr. Mark Graves, Director of the Income Tax Bureau.

²⁹Proceedings of Ninth State Tax Conference (March 19, 1920) *The New York State Tax Bulletin*, pages 171-175.

GIFTS—TAXABILITY OF.—

MR. GRAVES: It has been found, I believe, that substantial amounts of income were escaping actual taxation by the federal government. The federal revenue act and our statute both provide that the proceeds of a gift or the value of a gift is not income. That leads us to this situation. A man may buy some stock or some bonds or some other property of another kind which greatly appreciates in value, as has actually been the case in all recent years. If a man is so fortunate in the stock market that he gets in on a good thing like Crucible Steel last year, and he makes a million-dollar profit, he immediately wonders how he can get by with that and realize a profit without paying a large portion of it to the federal government and another small portion to the state government. The result is that he usually gives the property or stock to his wife and it is not income to her and she is not taxable on it. There has been income realized by someone. His stock sold for much more than it cost him, and someone should pay an income tax. In framing the comptroller's regulations—not relying on my judgment or the judgment of others in the comptroller's office, but at a conference with men whom we thought at least were well posted—men who had had something to do with framing the regulations by the United States government—we concluded that we might regulate, at least, that appreciation in value of property given is income to the donor, on the theory that if a man gives something he must have it at the time that he gives it. He cannot give something that he has not. If a man makes a gift of 100 shares of stock he does not measure his gift in the 100 shares, but he measures it in the money value of the stock at the time that the gift is made. We reason this way: Our statute tells in one section how gain or loss shall be calculated in case of a sale of property, and in the section immediately following it tells us how gain or loss shall be calculated in the case of the exchange of property. And in the first section it says "sale or other disposition" we have the words "other disposition." It occurs to me that those words are either superfluous in that section, or else they relate only to gifts, because what other disposition can there be made of property other than by sale or exchange? In other words, we clearly state the rule in our statute for calculating gain or loss in the case of sale and in the case of exchange, and still we have in our law the words "other disposition."

MR. TOBIN: Thank you, very much, Mr. Graves. I brought up the precise question because I know there are ever so many men present who are interested.

MR. ZOLLER: Mr. Graves will also state that in case there is a loss that the taxpayer gets the benefit of the loss?

MR. GRAVES: Precisely. The rule will have to work both ways.

MR. TANZER: A good deal of income now escapes by the making of gifts. I agree that the profit that escapes taxation ought to be reached; but I do not find myself able to agree with him as to the method by which the comptroller's office proposes to reach that profit, and for this reason: When the donor whose property has appreciated in value gives that property away, he does not realize a profit. What he does is to make it possible for someone else to realize a profit. All that the donor has when he gives away the property is an unrealized appreciation. It is true, as Mr. Graves argues, that a man cannot give away what he has not got. But he had it at the moment before he gave it away, and on that logic he should pay taxes when he had it before he gave it away, just as well as he should at the moment of giving it away. The very foundation of income tax law is that unrealized appreciation is not income. The Supreme Court of the United States has just declared unconstitutional the provision of the federal revenue law that an unrealized gain or profit is not taxable income.

Mr. Graves refers to the term "other disposition" as possibly including a gift. The reason, it seems to me, why "other disposition" cannot include a gift, is that not only must there be a sale or exchange or other disposition, but there must be a gain realized from the sale, exchange or other disposition, and when a man makes a gift he realizes no gain. Those who have studied the subject have proposed quite a different solution. The Treasury Department has transmitted to Congress a proposal that the donee be taxed on the basis of the amount of gain realized by sale over and above the cost to the donor. At first blush that may seem unfair and retroactive, and possibly it is; but that proposal may perhaps be defended on this ground, that it would be competent for Congress to treat the entire value as gain for which he has exchanged nothing, and therefore if Congress chooses to tax the donee in such lesser amount which would have come to the donor if he had retained the property, the donee has perhaps no great cause for complaint.

Another possible way is by way of an excise tax on the gift. A gift may be treated as income, but whether or not, I do not think there is much question that constitutionally either a state or Congress could impose an excise tax on a donee receiving a gift, just as it imposes a tax on a person receiving an inheritance; but I must say I cannot see any possible reason, in law or logic, for saying that the donor who parts with what he had and realizes nothing can be deemed to realize income from that gift.

MR. ZOLLER: You do not seriously contend that there is nothing in the federal or state constitution that prohibits the state from doing what Mr. Graves says they propose to do, notwithstanding the recent decision of the United States Supreme Court?

MR. TANZER: I do not think it can be considered as income. I think it might be quite competent for the state to impose a capital tax, but I am doubtful whether it might not be contended that a tax on unrealized gains in case the property is given away without also taxing others who retain property which has similarly appreciated, is so discriminatory as to be wanting in due process of law. I think there might be a serious question.

MR. HANDY: It occurs to me that there is some flaw in Mr. Tanzer's logic. If a man gives a gift to his wife worth \$500 he gets credit for a handsome gift. If I give a wedding present worth \$500 I expect to be invited to the home of my friends more frequently than if I gave a gift worth \$5. It seems to me that the value of the gift is to be determined at the time that the gift is made, and a man receiving a greater amount of credit for a large than for a small gift should certainly account for it on his income tax return, and not the donee. It may be that the entire value of the gift should be taxed against the donee; but it seems to me that it would be scarcely constitutional unless you impose the tax upon the entire amount of the gift and not simply on the increase of value over the amount that it was worth when the donee acquired it. There is a vast difference between giving a present of a sapphire ring and an emerald ring with precisely the same size stone, also there is quite a difference between making a gift of several shares of stock worth five and presenting the same stock at a time when it has appreciated fifty or one hundred dollars a share in value. So if a man acquires an additional credit it would be only fair and reasonable, according to Mr. Graves' logical plan, that the donor should pay the tax upon the additional value at the time the gift is made.

Basis for Ascertaining Appreciation of Property

The state law uses almost the same language as the federal statute³⁰ in prescribing the basis on which to compute gain.

Determination of the taxable profit derived from the appreciation of property is made, of course, by a comparison of the value of the property at two points of time. The federal statute designates the first point of time as March 1, 1913, while the state law fixes the date at January 1, 1919 (the date as of which the state income tax law became effective).

LAW. Section 353. For the purpose of ascertaining the gain

³⁰Federal law, section 202 (a).

derived or loss sustained from the sale or other disposition of property, real, personal or mixed, the basis shall be first, in case of property acquired before January first, nineteen hundred and nineteen, the fair market price or value of such property, as of January first, nineteen hundred and nineteen, and, second, in case of property acquired on or after that date, the cost thereof; or the inventory value, if the inventory is made in accordance with this article.

The difficulties which have been experienced in this matter relate to the application of the principles—not to the principles themselves. No trouble is experienced when an actual realization takes place. The trouble arises over the interpretation of “sale or other disposition of property,” in conjunction with “gain derived or loss sustained.”

Inventory method not applicable.—The measurement of gain in the case of property subject to inventory has been adequately discussed in the preceding pages. As to other property, the law plainly designates cost as the base from which to measure appreciation in the case of property acquired on or after January 1, 1919, and the value on that date for property acquired previously. The general provision of the regulations governing this point reads as follows:

REGULATION. For the purpose of ascertaining the gain or loss from the sale, gift, exchange, or other disposition of property the basis is (a) its fair market price or value as of January 1, 1919, if acquired prior thereto, or (b) if acquired on or after that date, its cost or its approved inventory value. In both cases proper adjustment must be made for any depreciation or depletion sustained. . . . (Art. 91.)

The foregoing ruling, unlike the federal regulation,³¹ specifically mentions gifts as one of the dispositions of property from which profit or loss may arise.³²

The words “or its approved inventory value” appear in the law as “or the inventory value, if the inventory is made in accordance with this article.”

Section 356 of the law grants to the Comptroller full au-

³¹Reg. 45, Art. 1561.

³²See page 201 for discussion of gifts.

thority to require taxpayers to inventory their assets, so long as the basis prescribed conforms "to the best accounting practice in the trade or business" and may be considered "as most clearly reflecting the income." It would seem that there is a very definite limitation upon the power of the Comptroller because it is not customary in any trade or business to inventory annually or periodically the capital assets. The inventory method is used only with trading assets. Although it might be highly desirable, no specific authority is given to prescribe inventories for those not engaged in trade or business.

No specified method of determining values.—

REGULATION. What the fair market price or value of property was on January 1, 1919, is a question of fact to be established by any evidence which will reasonably and adequately make it appear. . . . (Art. 92.)

The cost of reproduction is rarely a satisfactory basis for the determination of fair market value at any date. In many cases during the war, prices were paid far in excess of reproduction costs. Recent sales by willing sellers to willing buyers are the best bases of all, but the records of such sales are confined almost entirely to stock and similar exchanges. Reproduction cost, however, may be very useful evidence in establishing fair market value.

Determination of fair market price or value at January 1, 1919.—It should be noted that the law does not require the determination of "fair market value" on January 1, 1919, but "fair market price or value." If fair market price can be ascertained, nothing further is needed. But it must be "fair," that is, representative and not narrow.

The sale of a few shares of stock out of thousands is not a fair criterion. In addition the price must meet the common definition of "market," which infers a willing buyer and a willing seller.

If any one of these elements is lacking we use the alternative provided in the law, viz., "value."

WHAT IS "FAIR MARKET VALUE"?—The following extract from a decision³³ of the United States Supreme Court may be used as an authoritative guide in determining what is "fair market value."

DECISION. The market value of goods is the price at which the owner of the goods, or the producer, holds them for sale; the price at which they are freely offered in the market to all the world; such prices as dealers in the goods are willing to receive, and purchasers are made to pay, when the goods are bought and sold in the ordinary course of trade. . . . The defendant asserts . . . that the only way to arrive at the market value is to take the cost of production, to compute how much the manufacturer has actually disbursed in producing the goods, and that thus you have the actual market value. The United States, however, maintain . . . they are freely offered to all the world, and held at known and established rates; . . . and at which they are ready to furnish them to all the world. If this latter state of facts be true, then it is evident that the prices at which the producers so hold them are the market prices. . . .

Value of mines, oil wells, etc., at January 1, 1919.—Article 190 states that "until specific regulations on the subject of depletion are issued and promulgated by the state Comptroller," the federal regulations will be followed, excepting that value at January 1, 1919, instead of March 1, 1913, will be used. The state presumably will use the same methods as the federal authorities, who now base their valuation of mineral property on the present worth of the income to be derived from the property over its estimated life.³⁴

Value of claims for infringements, judgments, claims, etc., January 1, 1919.—The state takes the same position as the federal Treasury in valuing claims, judgments, etc., at a given date, viz., that they should consist of definite assignable rights at the date at which a value is placed upon them.³⁵

³³Cliquots Champagne, 3 Wall. 114.

³⁴For specific example of mine valuation, see *Income Tax Procedure*, 1921, pages 409-411.

³⁵See page 148.

RULING. A motion picture company was organized in 1914. A partnership which financed this company upon its failure to show any signs of making a profit, took as security for the partnership claim, a judgment which the company held against X corporation. The motion picture company is without resources. As a result of litigation this judgment was reversed in the spring of 1920. The partnership asks if the value of this judgment is deductible as a loss?

Sufficient facts are not presented to determine whether or not the X corporation was solvent on January 1, 1919. If such corporation was liable for the full amount of the judgment at that time and the court decision is now final, the partnership may deduct as a loss the value of the judgment as of January 1, 1919. (Question 97, Comptroller's Questions and Answers, 1921.)

Value of goodwill at January 1, 1919.⁸⁶—

No specific rulings have been issued by the state as to how to value goodwill, but the three principal methods used by the federal authorities may be described as follows:

1. The difference between the price at which an article is sold under the trade-name and under no trade-name multiplied by the number of units sold during the year equals profits attributable to goodwill. Capitalize this at 20 per cent.

2. Comparison with businesses having similar sales and profits when such companies have goodwill purchased for cash.

3. An allowance out of average earnings over a period of years prior to March 1, 1913, preferably not less than five years, of a return of 10 per cent upon the average tangible assets for the period. The surplus earnings will then be the average amount available for return upon the value of the intangible assets, and this return should be capitalized upon the basis of not more than five years' purchase—that is to say, five times the amount available as return from intangibles should be the value of the intangibles.

It was held that the 10 per cent was to be applied to the *net* tangible assets. Of course, the smaller the average *net* tangible assets to be capitalized, the greater will be the earn-

⁸⁶For full discussion of goodwill valuation, see *Income Tax Procedure*, 1921, pages 413-419.

ings to be capitalized at 20 per cent to establish the goodwill value.

In businesses that are more or less stable, 8 or 9 per cent return on tangibles and capitalization of the earnings applicable to goodwill at 15 per cent has been suggested.

Average of stock quotations of January 1, 1919.³⁷—

REGULATION. . . . In the case of securities dealt in on a recognized exchange, the fair market value on January 1, 1919, will ordinarily be determined by the average of the bid and asked prices after closing on December 31, 1918. In all other cases other evidence of value is necessary and bona fide sales nearest January 1, 1919, of securities publicly or privately dealt in, or appraisals for inheritance or similar purposes, will be considered. (Art. 92.)

When only a few shares were sold before and after January 1, 1919, taxpayers may claim that such sales were not representative nor controlling. The federal authorities take this view in establishing values. It has also been the federal practice to permit values fixed by appraisers of state courts to be rebutted when it could be shown that such appraisals were merely nominal.

Income from Appreciation of Property Values

In the preceding pages the discussion has been concerned with the taxation of appreciation when there has been a realization or what the state deems to be the equivalent of realization. There is an honest doubt about the legality and advisability of taxing realizations, but there can be no doubt about the inequity and ultimate impossibility of taxing appreciation which has not been realized to such an extent that the taxpayer has in hand cash or its equivalent sufficient at least to pay the tax assessed thereon.

The author believes that realized capital gains, that is to

³⁷Instructions 27, page 2 of instructions, form 201, read in part as follows:

"You can ascertain the January 1, 1919, valuation of most securities at any district office of the New York State Income Tax Bureau."

say, realized appreciation, should be taxed as income. But it should be quite clear that there is a gain *and* a realization.

One of the statements in the present regulations (the language is the same as that in the federal regulation dealing with this subject)³⁸ can hardly be improved as an expression of an equitable basis of taxation. "Both a change in substance, and not merely in form, and a change into the equivalent of cash are required to complete or close a transaction from which income may be realized." This is the principle upon which the author has based his rather extended arguments in *Income Tax Procedure*, 1921.

Most of the difficulty arises from the lack of a comprehensive definition of "net income." The definition in the state law is similar to that of the federal law.³⁹

LAW. Section 357. The term "net income" means the gross income of a taxpayer less the deductions allowed by this article.

and section 359 states that:

LAW. Section 359. The term "gross income":

1. Includes gains, profits and income derived from . . . businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property;

The words "gains, profits and income" might be construed to include unrealized as well as realized gains, were it not for the impracticability of attempting to tax unrealized capital gains.

In a recent decision⁴⁰ one of the federal district courts held that appreciation in value, even though realized, is not income.

DECISION. . . . I feel constrained to hold that the appreciation in value of the plaintiff's bonds, even though realized by sale, is not income taxable as such, and in reaching this conclusion I find support for it in the *Macomber* case where Mr. Justice Pitney says: "Enrichment through increase in value of capital investment is not income in any proper meaning of the term."

³⁸Reg. 45, Art. 1563.

³⁹Federal law, Sections 212 (a), 213.

⁴⁰*Brewster v. Walsh*, U. S. District Court (Conn.), December 16, 1920.

It follows that the Income Tax Law of 1916, in so far as it attempts to tax such increase, is in conflict with the apportionment requirements of the First Article of the constitution, being a direct tax and not apportioned among the several states according to population. . . .

The effect of this decision, if upheld by the United States Supreme Court, is in doubt, as far as the state of New York is concerned, as there is no inhibition in the state constitution on the taxation of capital gains.

Surplus arising from reappraisals is not taxable income.— Increased valuations from writing up capital asset values are not subject to income tax, but revaluations as of January 1, 1919, should be used as bases for depreciation and depletion charges,⁴¹ and this requires that the appraisals be entered in the books. Property accounts will be debited and "surplus arising from reappraisement of property" will be credited. The latter account is equivalent to a capital surplus account, excepting that part of the appreciation which may subsequently be realized and should then be transferred to an account which on a balance sheet and for income tax purposes would be called "earned surplus." In order to avoid its inclusion as income for the taxable year, the amount on the books should be credited to "surplus earned prior to January 1, 1919."

Appreciation in stock exchange seat.—

RULING. A stock broker questions if he is required to report as taxable income \$10,000 appreciation in the value of the stock exchange seat held by him?

No. Income in this instance is not realized until he disposes of the stock exchange seat. (Question 33, Comptroller's Questions and Answers, 1921.)

⁴¹See Chapter XV.

CHAPTER X

INCOME FROM PERSONAL SERVICES

The federal and state laws and the courts have been more or less lenient with business and capital gains and profits, and in comparison the recipient of income from personal services has been dealt with almost harshly. In most cases the salaried employee and the professional taxpayer are taxed on gross income. Some deductions are permitted, but always to a limited extent. The principle that earned income should be taxed more lightly than unearned income has been almost wholly ignored in this country, and when there has been any differentiation it has favored the unearned income. On the other hand, in Great Britain, earned income is taxed at a lower rate than unearned income. The only reason given by our legislators for this inequity is the difficulty of differentiation; but a careful study by the author of the investigations and hearings by the tax committees of Congress and the state legislature does not indicate that any sympathetic attempt has been made in the United States to recognize the justice of imposing a lighter tax on those whose brain capital is being used up than on those whose capital is permanent. Moreover, in the latter case depletion, depreciation, obsolescence and losses are allowable, whereas in the case of the brain worker no deduction for wear and tear is permissible.

Summary of Differences Between State and Federal Procedure

The salaries of all employees of the state and its political subdivisions are exempt from federal income tax but, with certain exceptions, are subject to state tax. (See page 215.)

The salaries of all federal employees which, with certain

exceptions, are subject to federal income tax, are exempt from state income tax. (See page 216.)

The pay of soldiers and sailors is not taxable at all under the state law, while under the federal law not more than \$3,500 for service during the present war is exempt. (See page 216.)

Compensation for services rendered prior to January 1, 1919, is not taxable under the state law, even though received after that date. The corresponding date under the federal law is March 1, 1913. (See page 218.)

The state regards all so-called "Christmas presents" to employees as additional compensation to them and as expense to the employer. Under the federal practice such items are sometimes regarded as gratuities not deductible as an expense by the employer and not additional compensation to the employee. (See page 221.)

Under state procedure, pensions, if paid by the state, are taxable to residents; if paid by the United States, not taxable. The converse of this is true in federal practice. (See page 225.)

A pension from a pension fund to which an employee has contributed is taxable only to the extent that it exceeds the aggregate amount of all payments or contributions made by the employee to the fund. There is no similar federal provision relating specifically to pensions, but the point is probably covered by the federal regulation on annuities. (See pages 225, 226.)

The state rules that a person receiving salary and a per diem allowance must return as income the excess of the allowance over the actual expenses. When the expenses exceed the allowance such excess is not deductible. This is similar to the federal ruling before its amendment in January, 1921. The federal practice now is to treat as income or allow as an expense the difference between actual expenses and the per diem allowance, adjusted by the saving of such expenses at home. (See page 227.)

Taxable and Exempt Income from Personal Services

The language of the state law is almost identical with that of the federal law.

LAW. Section 359. The term "gross income":

1. Includes gains, profits and income derived from salaries, wages or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, . . .

Compensation of certain officers exempt.—Proceeding on the same principle as that followed in the federal rulings, the Attorney-General of the state has ruled that the salaries of certain state officers are not subject to tax, on the theory that the constitution prohibits a diminution of their compensation¹ during their terms of office.²

RULING. Under what provision of law has the State recently refunded to the county judges of the State the amount of tax which they paid on account of their compensation as such officers?

The law contains no provision requiring this refund. The United States Supreme Court in the case of *Evans v. Gore*³ (June 1, 1920), in interpreting certain language in the Constitution of the United States, to the effect that judges shall receive for their services compensation which shall not be diminished during their continuance in office, concluded that the federal tax on incomes in the case of these officials was imposed contrary to the provisions of the Constitution and was therefore invalid. In view of this decision the Attorney-General of this State directed the Comptroller to make refund to constitutional officers in this State of the amount of income taxes paid on account of their salaries. This opinion of the Attorney-General specifically stated that officers whose salaries are subject to action by the Legislature, who are elected subsequent to the enactment of the personal income tax law (chapter 627, Laws 1919) are subject to this tax. (Question 1, Comptroller's Questions and Answers, 1921.)

Compensation of state officers in general not exempt.—

REGULATION. Compensation paid its officers and employees by the State of New York or any other state, or any political subdivision thereof, including fees received by notaries public commissioned by

¹Federal law, section 213 (a).

²Attorney-General's Income Tax Letter No. 38, dated August 30, 1920, quoted on page 51.

³253 U. S. 245.

states and the commissions of receivers appointed by State courts, and including amounts paid to officers and employees while in the military or naval service, is taxable. Employees of universities receiving salaries paid in part or in whole from funds available under the Smith-Lever Act of May 8, 1914, who are officers or employees of a State, are required to return as taxable income the salaries so received. This is also true with respect to the Act of August 30, 1890, relating to colleges for the benefit of agriculture and the mechanic arts, and to the Act of March 2, 1887, relating to agricultural experiment stations in such colleges. (Art. 24.)

Salaries of federal officers and employees exempt.—The state law⁴ specifically exempts all compensation received by officers and employees of the United States, including persons in the military or naval forces. The corresponding exemption of state employees from federal tax is not contained specifically in the federal law, but rests on an opinion of the Attorney-General.⁵

Pay of soldiers and sailors entirely exempt.—Compensation of soldiers and sailors of the United States is not taxable at all by the state,⁶ but under the federal law the amount in excess of \$3,500 is taxable. Compensation received by soldiers and sailors from other sources, however, is taxable.⁷

Contractor for public work not a public employee.—

REGULATION. Where warrants are issued by, or in behalf of, a state, city, town, or other political subdivision of a state, and are accepted, in payment, the fair market value of such warrants at the time of receipt must be returned as income. When a contractor receives payment in stock, bonds or other obligations of a corporation other than as stated above, such securities shall, for the purpose of determining gain or loss be treated as the equivalent of cash to the amount of their fair market value. If upon conversion of the warrants or securities into cash or other property, the contractor receives an amount or value greater or less than the value so returned, the profit or loss so realized or sustained shall be reported in the

⁴Section 359, 2, f.

⁵See *Income Tax Procedure*, 1921, page 297.

⁶See page 39.

⁷Article 24; see above.

return for the year in which such warrants or securities are converted. (Art. 27.)

The foregoing ruling is sound. The corresponding federal ruling⁸ which is not sound, requires that "the face value of such warrants must be returned as income." Income, of course, does not depend on par or face value.

Income from jury fees.—

RULING. Are amounts received for jury services taxable?

Yes, if they are received for services on the jury other than one impaneled for a United States Court, in which case compensation would not be taxed because it was paid by the United States Government. (Question 14, Comptroller's Questions and Answers, 1921.)

Accounting Procedure

Receipt and accrual methods.—The state gives definite recognition to the accrual method of reporting compensation, as is shown in the following:

RULING. During 1919-1920 an employee of a manufacturing corporation was paid both straight salary and commissions. On the 1919 sales no commission was paid until March, 1920. On January 1, 1920, he knew that he was to receive some amount but it was not definite because the company's books were not to be closed until March, 1920. At that time he received \$720 on account of commissions for 1919 sales. Is this amount taxable in his 1920 return?

If the taxpayer is reporting on an accrual basis, he should include this amount as income for the year 1919; if reporting on a cash basis, he may report it as of the year 1920, when received. (Question 5, Comptroller's Questions and Answers, 1921.)

TAXPAYER MAY ELECT TO REPORT ON CASH OR ACCRUAL BASIS.⁹—

RULING. Is an election permitted a taxpayer in his first taxable year, who has earned but is not paid any compensation in that year, to file no report but include the amount received in his report for the following year, or may he report the amount for the year in which he performed the services?

Taxpayers are permitted to file their returns on either a cash

⁸Reg. 45, Art. 37.

⁹Article 24; see page 216.

or accrual basis. If this taxpayer chooses to file on a cash basis, he would not file any return for the first year; a return for that year would be required, however, if his accounting records were kept on an accrual basis. (Question 120, Comptroller's Questions and Answers, 1921.)

ACCRUAL BASIS NOT PERMITTED UNLESS COMPENSATION IS DETERMINED.—

REGULATION. Where no determination of compensation is had until the completion of the services, the amount received is income for the taxable year of its determination. . . . (Art. 23.)

It is of course difficult to accrue an amount which is not determined. When a tax rate is not highly progressive it makes little difference; but when the rate is heavily graduated the taxation in one year of an amount received for personal services which has been accruing over several years is a positive hardship which should be alleviated. One practical suggestion is that the taxpayer report an estimated amount on an accrual basis and in the year of receipt report only the balance as income for that year. This means more or less of a gamble, as something may happen and the ultimate collection may be considerably under the estimate. The equitable method, and one within the power of the Comptroller to authorize, is to permit the taxpayer to prorate the earnings over the entire period or allocate the earnings to the periods in which they actually accrued and submit amended returns. As heretofore stated, those in receipt of salaries and fees are the victims of sufficient discrimination without unnecessarily adding to their hardships.

Compensation for services rendered before January 1, 1919—how far taxable.—The following ruling adopts the same principle as that contained in the federal regulation.¹⁰

RULING. Answering your inquiry of January 26, you are advised that payments for any personal services completed in 1918, although not paid for until 1919, are not taxable, and should not be included in the tax return. This applies also to payment for legal services

¹⁰Reg. 45, Art. 87.

rendered in 1918 but not paid for until 1919. Where services are not completed until 1919, even though the value of such services when completed has been determined in 1918, if the services are of such a nature that a value cannot well be placed upon separate portions thereof, no apportionment will be allowed and the amount received as compensation therefor must be included in gross income for the year in which the services were completed. However, if the value of the services performed in 1918 can be separated from the value of the services rendered after January 1, 1919, the income earned in 1918 is not taxable.

The test is not the ability to apportion fees earned in 1918 and 1919 but whether on December 31, 1918, a valid claim existed for services rendered in 1918, which claim was determinable, assignable and collectible on that date. If no such claim existed on December 31, 1918, fees for services rendered prior thereto must be included in gross income for the year of their determination or receipt according to the method of accounting employed by the taxpayer. (Official ruling, dated January 30, 1920.)

The foregoing principle is amplified in the following article. The author ventures to suggest that a professional man should be versatile enough to determine the accrual at December 31, 1918. It is not intended that any income accrued prior thereto should be taxed; therefore a bona fide segregation of income collected thereafter, even though no more than a rough estimate can be made, is a sufficient compliance with the law. If there is any doubt, the taxpayer, not the state, is entitled to it.

FEES FOR PROFESSIONAL SERVICE.—

RULING. Your letter of January 22, requesting an interpretation of Article 79¹¹ of the Regulations, as applied to fees of professional men raises six possible situations:

- (a) Where a lawyer rendered a bill in March, 1919, for services covering a period including a part of 1918;
- (b) Where the bill rendered includes separate and distinct items of services such as preparation of a will, drawing of agreements, incorporation of a company, all of which separate matters were closed and completed before January 1, 1919;
- (c) Where a bill was rendered as in "b" and a gross sum was charged including not only those services but also services

¹¹See page 148.

rendered in 1919 without specific apportionment on the books;

- (d) Where in the case of a receivership, attorneys received in 1919, a payment on account of services rendered during a period including part of 1918;
- (e) Where an attorney rendered a bill for 1919 for services performed in a single matter not concluded until 1919, but covering a period including part of 1918;
- (f) Where an attorney received an annual retainer, payable quarterly or semi-annually.

You are advised that in order to exclude any part of the fees or compensation received in 1919, from your return for that year on the grounds that part of the services were rendered and performed in 1918, there must have existed on January 1, 1919, a valid unconditional claim for services rendered, which claim was both determinable, assignable and collectible. The ability to apportion a part of the whole compensation to the year 1918 and 1919, is not by itself sufficient.

Applying this reasoning to your specific cases, it follows that if in "a" the attorney could separate his bill for services into two parts, that earned in 1918 and that earned in 1919, and thereby show separate and distinct items of services closed and completed December 31, 1918, that part of the amount received later which represents the value of the claim existing on January 1, 1919, need not be included in the 1919 return.

From the facts stated in "b" it is evident from the above, that no part of a compensation received in 1919 need be included in the 1919 return.

In "c" we have the situation as in "b" with the additional fact that further services were performed in 1919, but only one bill rendered in 1919. This, therefore, presents a case where an unconditional claim accrues to the creditor and exists on January 1, 1919, as the attorney could separate the items of services rendered in 1918 from those rendered in 1919, and if necessary, present two bills for the services thus performed.

The test in "d" and "e" is whether, if the attorney under the facts as therein stated, had withdrawn on January 1, 1919, he could have rendered a bill for services performed up to December 31, 1918, which represents a fixed, collectible and assignable claim.

"f" presents a clear case where the attorney can exclude from his 1919 return that portion of his annual retainer earned and accrued in 1918, although not paid until 1919. (Official ruling, dated February 7, 1920.)

The foregoing ruling is sound so far as the principle of not taxing any income which accrued prior to January 1, 1919, is

concerned. The theory of assignability is not so sound. There might be an accrual of income even though the claim could not be assigned to another. It is doubtful if any part of an annual retainer could be assigned. A better method would be to apportion to 1918 and prior years the amount which would be collected if the taxpayer had died on December 31, 1918.

Gifts or bonuses to employees.—The state has eliminated the necessity which exists under the federal ruling¹² of determining whether Christmas presents to employees are gratuities or additional compensation. The state regards all such “presents” as compensation and taxable to the employee.

RULING. As requested orally I have considered the question: Are gratuities given by the New York Clearing House to its employees at Christmas time to be regarded as income to the employees, or as gifts?

I think that ordinarily a Christmas present to an employee partakes more of the nature of reward for faithful service—compensation—than of the nature of a gift. Of course the element of a gift that is voluntary, is present, but can we say that it is without consideration, past or present, legal or moral?

In the case of a corporation organized for profit to its stockholders or members, the making of gifts, pure and simple, would be clearly *ultra vires* (except contributions to war charities specially authorized by statute) and any gratuities or bonuses to employees are justified upon the ground that they are in consideration of services, past or expected.

The New York Clearing House is an association of banking institutions. Those members which are corporations cannot make gifts, pure and simple. They contribute their proportion of the expenses of the Clearing House on the theory that their membership therein is necessary *as a part of their* business. And the only basis upon which they can, lawfully, pay their share of the Christmas gratuities, is that it is a part of their business. Unquestionably it tends to improve the morale of the employees, and encourage faithful service. It is good business to pay these bonuses—and business, not generosity, is supposed to be the motive actuating bank directors. Business involves the theory of a *quid pro quo* (past, present, or future) and that, in turn, excludes the possibility of regarding these payments as pure gifts. They must, to be lawful, be based upon consideration. The only possible considera-

¹²Reg. 45, Art. 107.

tion is services, past or future. I can not avoid the conclusion that you must regard these payments as personal service compensation. (Attorney-General's Income Tax Letter No. 14, dated January 13, 1920.)

Bonus received in 1921 based on 1920 business.—If a taxpayer reports on the accrual basis, it is proper to account for a bonus received in 1921, based on 1920 business, as 1920 income. If the return is prepared on a cash basis, such a bonus should be reported as income of the year in which it was received.

RULING. If a taxpayer reports on a cash basis for the year 1920 and in February, 1921, received a bonus based on the volume of business done by his employer in 1920, is the taxpayer required to consider this as taxable income received in 1920?

No. The bonus is reportable in the 1921 return of the taxpayer. (Question 56, Comptroller's Questions and Answers, 1921.)

Commissions, fees and tips are taxable.—

REGULATION. . . Commissions paid salesmen, compensation for services on the basis of a percentage of profits, commissions on insurance premiums, tips, retired pay, pensions and retiring allowances paid by States and political subdivisions or private persons, are income to the recipients; as are also marriage fees, baptismal offerings, sums paid for saying masses for the dead, and other gifts and contributions received by a clergyman, evangelist or religious worker for services rendered. . . (Art. 23.)

The above regulation is identical with the federal ruling,¹³ excepting that pensions paid by states, etc., are taxable by the state but not by the federal government, whereas pensions paid by the federal government are not subject to tax by the state but are subject to federal tax.

When compensation is based on a percentage of profits the question arises as to whether or not taxes should be eliminated from profits in computing the bonus. When the agreement between the parties contemplates taking taxes into consideration, the bonus may be readily computed by formula.¹⁴

¹³Reg. 45, Art. 32.

¹⁴See *Income Tax Procedure*, 1921, page 310.

Renewal insurance commissions—policies written prior to January 1, 1919.—The state first held commissions on renewal insurance premiums not to be taxable, on the theory that the services in earning the commissions were all rendered prior to January 1, 1919, even though premiums were paid and commissions on them were received after that date.

RULING. The income tax bureau ruled sometime ago that where an agent of an insurance company had written a policy prior to January 1, 1919, but under his contract was entitled to receive commissions upon premiums paid after that date to continue the policy in force, the earning of which commissions required no further act on the part of the agent, they will be regarded as money earned and accrued prior to January 1, 1919 and not be deemed taxable under the income tax law.

In making such ruling the Bureau was undoubtedly thinking entirely of the fact that no further act on the part of the agent was necessary to entitle him to the renewal commissions and that his work was entirely done prior to January 1, 1919; and overlooked the fact that the payment of such renewal commissions was necessarily contingent upon the payment of premiums by the policy holder after January 1, 1919. At the time the agent did his work there was no possible way of telling how many renewal commissions would become due. If we had had an income tax law prior to 1919 the renewal commissions certainly could not have been taxed at the time the policy was written. That being the case, they are to be regarded as taxable at the time they are received.

The Federal income tax law and the State income tax law are similar in their provisions with respect to the inclusion of earnings in gross income and the Federal government made rulings with respect to moneys earned prior to March 1, 1913 and paid thereafter similar to the general rules adopted in the regulations of our income tax bureau.

The Federal courts were called upon to pass upon the question of the taxability of renewal commissions on policies written prior to March 1, 1913 and they held that such commissions were taxable when received. The soundness of the reasoning in these cases is unquestionable and I advise you that they should be accepted as precedents.

I advise that you amend your rulings and treat renewal commissions as taxable to the agents when received by them regardless of the time at which the policies may have been written. (Attorney-General's Income Tax Letter No. 40, dated December 17, 1920.)

The Attorney-General has based his opinion on the fact

that the amount of the commissions is not definitely determinable, for, in ruling¹⁵ that no withholding is required on such commissions, he says: "If they were calculable at the time the service was rendered, my decision in Income Tax Letter No. 40 would have been the other way."

As a matter of fact, such commissions are calculable, but some contingency, such as the death of the assured, will result in their not being received by the agent.

AMENDED RETURNS REQUIRED FROM INSURANCE AGENTS.—

RULING. Upon further consideration of the question of taxing renewal commissions on insurance policies written prior to January 1, 1919, and after examination of the opinions of the Attorney-General in income tax letters Nos. 40 and 41,¹⁶ all former rulings of this office holding that renewal commissions on insurance policies written prior to January 1, 1919 were not taxable are hereby superseded. It is now held that renewal commissions on policies of life, health or accident insurance are taxable income to a resident or to a non-resident in the year when received, irrespective of the time at which the policies may have been written.

Taxpayers who received such renewal commissions in 1919, which were not included in their respective returns of income for that year, are required to file amended returns, including therein as income such commissions, and to pay any additional tax due. Those who failed to file returns for the reason that by the exclusion of such commissions they were not subject to tax, are required to file returns including such commissions as income and to pay any tax due.

Partnerships which excluded renewal commissions from income reported for 1919 should file amended returns including such commissions as income and show the additional amounts distributed or distributable to the individual partners. The latter should thereupon file new, or amended, individual returns, as the circumstances require, reporting such additional income and pay any additional tax due.

Fiduciaries, who received renewal commissions in 1919 resulting from insurance policies written by a decedent during his lifetime, should file amended returns of information on Form 205 showing the additional income distributed or credited to beneficiaries by reason thereof; or, if an estate is taxable as an entity, the fiduciary should make a new return, or an amended return, as the cir-

¹⁵Attorney-General's Income Tax Letter No. 41, see page 139.

¹⁶See pages 139, 223.

cumstances may require, including such commissions as income, and pay any tax due by reason thereof.

Returns which have been heretofore audited and upon which refunds have been made under authority of former rulings, will be subject to re-audit and assessment of additional tax. Taxpayers to whom such refunds have been made should, however, file amended returns at once, including such commissions as income, and repay the amount so refunded.

New returns, or amended returns, made by reason of this ruling will be received on or before April 15, 1921 without interest or penalties.

Deducting and withholding with respect to such payments is not required of insurance companies, or general agents, but returns of information must be filed with respect to such payments made after December 31, 1919. (Special ruling signed by James A. Wendell, Comptroller, by Mark Graves, Director, State Income Tax Bureau, and dated January 18, 1921.)

Pensions.—

REGULATION. Pensions are classified as follows:

(1) Periodical payments made to persons retired from service (a) after reaching a specified age, or (b) after a stated period of employment, or (c) on account of disability.

(2) Compensation for personal injuries or sickness.

Both classes of pensions may be paid out of funds to which the recipient has contributed, or out of funds to which the recipient has made no contribution.

First.— ¹⁷

Second.—When received by a resident, a pension is not taxable (a) when received from the United States Government, or (b) if received as compensation for personal injuries or sickness, or for accident or health insurance, or under workmen's compensation acts, or through war risk insurance, or under any law for the benefit or relief of injured or disabled members of the military or naval forces of the United States. Pensions arising upon retirement for disability are not regarded as compensation for personal injuries within the meaning of this paragraph. Pensions received from the New York City Teachers' Retirement Fund are exempt from taxation.

Third.—All other pensions received by residents are taxable.

Fourth.—If the recipient has contributed to the fund out of which the pension is paid, the pension receipts are taxable only when, and to the extent that, they exceed the aggregate amount of all payments or contributions made by him to the fund. (Art. 41.)

¹⁷Pensions received by non-residents are not taxable. See Chapter XVIII.

There is no federal ruling similar to that in the last paragraph above relating specifically to pensions, but it is thought that article 47 of Regulations 45 on annuities covers the case.

PENSIONS OF POLICE AND FIREMEN NOT EXEMPT.—In a recent opinion¹⁸ the Attorney-General held that the provisions of the Greater New York charter do not exempt from the state income tax law pensions paid policemen and firemen.

PENSIONS FROM STATE TEACHERS' RETIREMENT FUND BOARD TAXABLE.—

RULING. Replying to your inquiry of January 14, you are advised that a pension received from the State Teachers' Retirement Fund Board is taxable income. However, if the recipient has contributed to the fund out of which the pension is paid, the pension receipts are taxable only when, and to the extent that, they exceed the aggregate amount of all payments or contributions made by you to the fund. (Official ruling, dated January 16, 1920.)

PENSIONS OF RAILROAD EMPLOYEES TAXABLE.—

RULING. A retired railroad employee who started receiving a pension prior to the turning over of the railroad to federal control, asks if the amount of pension which he received from this corporation during the time that the roads were under such control, is taxable.

Yes, on the assumption that the pension payment will be continued after the railroads are returned to private ownership. (Question 8, Comptroller's Questions and Answers, 1921.)

Compensation of the clergy.—Clergymen are not taxable on the income received and specifically used for religious, etc., purposes,¹⁹ but are taxable on personal earnings and other income.

RENTAL OF PARSONAGE IS ADDITIONAL COMPENSATION.—

RULING. Answering the inquiry contained in your letter of January 9, you are advised as follows: A regularly employed pastor living in a parsonage owned by the church, should in addition to his regular salary include in gross income the value to him of the parsonage furnished. This will be determined largely upon the rental

¹⁸Income Tax Letter No. 13, dated January 7, 1920.

¹⁹Section 359, 2, g.

value of the property in each community. (Official ruling, dated January 12, 1920.)

Compensation other than in cash.—Section 359 requires that compensation for personal services must be reported even if received in some form other than cash.

REGULATION. Where services are paid for with something other than money, the fair market value of the thing taken in payment at the time such payment is made is the amount to be included as income. If the services were rendered at a stipulated price, in the absence of evidence to the contrary such price will be presumed to be the fair value of the compensation received. . . .

Compensation received in the form of rent and board.—

When living quarters such as camps are furnished to employees for the convenience of the employer, the rental value need not be added to the cash compensation of the employee, but where a person receives as compensation for services rendered a salary and in addition thereto living quarters, the value to such person of the quarters furnished constitutes income subject to tax. . . . (Art. 25.)

Under the foregoing ruling, board and lodging furnished to servants is part of their compensation. Employers should be careful to report (as they are legally bound to do under heavy penalties)²⁰ the value thereof when the cost or value plus wages is in excess of \$1,000 per annum.

Compensation received in the form of heat and light, telephone, automobile and other services.—The principle laid down as to board and lodging applies to all other facilities furnished as part of the compensation of employees.²¹

Compensation received in the form of per diem allowances and mileage.—Article 118²² provides that when a person receives a salary and a per diem allowance the excess of the cost of meals and lodging is not deductible, but "any excess of the allowance over the actual expenses is taxable income."

²⁰See Chapter VI.

²¹See *Income Tax Procedure*, 1921, page 6.

²²See page 274.

This is practically the same as the federal ruling²³ on the same subject before amendment, January 1, 1921. The state in this case discriminates against the person receiving a per diem allowance as compared with one receiving a salary, by not permitting as a deduction the excess of the cost over the per diem allowance. The federal rulings now treat both classes alike, and the state should do likewise.

"Supper money" has been held to be additional compensation,²⁴ but the correctness of this state ruling is questionable. The federal ruling is exactly the opposite.

Premiums paid by employer on group life insurance, not income to employee.²⁵—

RULING. Referring to your recent inquiry relative to the premiums paid on behalf of your employees on the group insurance plan, you are advised that this office will follow the Federal interpretation in this regard, holding that in the case of group insurance, the premium paid for and on behalf of the employee; need not be reported as additional income to the employee. (Letter to The Corporation Trust Company, signed by Roy H. Palmer, Acting Chief, Information Division, Income Tax Bureau, and dated December 22, 1920.)

Compensation received in the form of stock.—

REGULATION. . . . Compensation paid an employee of a corporation in its stock is to be treated as if the corporation sold the stock for its market value and paid the employee in cash. . . . (Art. 25.)

Compensation in form of promissory notes.—

REGULATION. Promissory notes received in payment for services, and not merely as security for such payment, constitute income to the amount of their fair market value. A taxpayer receiving as compensation a note regarded as good for its face value at maturity, but not bearing interest, may properly treat as income as of the time of receipt the fair discounted value of the note at such time. Thus,

²³Reg. 45, Art. 292.

²⁴Ruling in *New York Times*, February 5, 1921.

²⁵[**Former Procedure**] Article 25 held premiums to be taxable when paid by the employer.

if it appears that such note is or could be discounted, the recipient may include such note in his gross income to the amount of its face value less discount computed at the prevailing rate for such transactions. If the payments due on a note so accounted for are met as they become due, there should be included as income in respect of each such payment so much thereof as represents recovery for the discount originally deducted. (Art. 26.)

Compensation received in the form of deductions for pension funds.—

REGULATION. . . . Contributions to retirement or pension funds accomplished by deduction from the compensation otherwise payable to the employees are income to the employees. (Art. 25.)

CHAPTER XI

INCOME FROM INTEREST, ROYALTIES, RENTS AND DIVIDENDS

There are important distinctions between federal and state practice in the taxation of interest and dividends. These differences, fully discussed in this chapter, are summarized below. Royalties and rents are taxable similarly under the state and federal laws.

Summary of Differences Between State and Federal Procedures

The following items of income which are taxable or partly taxable under the federal law are entirely exempt to residents under the state law:

1. Interest on obligations of the United States. (See page 232.)
2. Interest on bonds of the War Finance Corporation. (See page 232.)
3. Interest on "investments" on which the investment tax was paid between June 1, 1917, and May 14, 1919, for period for which paid. (See page 232.)
4. Interest accrued prior to January 1, 1919. (The corresponding date in the federal law is March 1, 1913.)
5. Dividends declared payable to stockholders of record prior to January 1, 1919. (The time when profits distributed in dividends were earned by the corporation is of no significance under the state law.) (See page 251.)

The state taxes the following items of income which are entirely exempt under the federal law:

1. Interest on obligations of states other than New York and political subdivisions thereof. (See page 234.)

2. Dividends paid from surplus accumulated prior to March 1, 1913. (See page 249.)
3. Dividends paid by personal service corporations from earnings accumulated since January 1, 1918, and prior to the taxable year. Such earnings are taxed by the federal laws to the stockholders as if they were partners and hence are not taxable again when distributed as dividends. (See page 252.)

Distributions in liquidation are taxable under the state law to the extent to which they exceed the fair market value of the stock on January 1, 1919. The corresponding date in the federal law is March 1, 1913. (See page 257.)

British income tax withheld on dividends may be credited against the federal tax, but not against the state tax, excepting to a certain extent in the cases of non-resident individuals, partners and estates. (See Chapter XVIII.)

Profits on sale of patents are computed on the basis of fair market value at January 1, 1919 (if acquired prior thereto), while the corresponding date for federal purposes is March 1, 1913. (See page 243.)

Non-residents are not taxed by the state on income from annuities, interest on bank deposits, interest on bonds, notes or other interest-bearing obligations or dividends, excepting when they are a part of income received from a business. The non-resident, however, must return such income for federal purposes, but annuities are not taxable until the aggregate amounts received exceed the amount paid. (Chapter XVIII.)

When the taxpayer receives stock dividends of a character or preference materially different from that of the stock on which the dividends are paid, the federal practice provides for allocating the cost of the old stock to the old and new stock respectively in proportion to the market values of old and new shares at the date of issue of the new shares. The state practice is to divide the cost of the old shares by the number of old and new shares, as is done when the ordinary type of stock dividend is received. (See page 262.)

Tax withheld on tax-free covenant bond interest is credited on the federal return against the total tax. No such credit is permitted on the state return. (See page 299.)

Income From Interest

The state taxes all interest, whether on notes, bank deposits, securities, bonds, mortgages or deeds of trust, bonds issued in foreign countries or upon foreign mortgages or like obligations, excepting the following:¹

1. Interest upon bonds or other obligations of the United States.

Such interest on certain issues in excess of certain exemptions is taxable under the federal law,² while totally exempt under the state law.

2. Interest on securities issued under the provisions of the Federal Farm Loan Act of July 17, 1916, and on bonds of the War Finance Corporation.

Under the federal law³ interest on bonds of the War Finance Corporation, in excess of \$5,000 par value, is taxable.

3. Interest on bonds or other obligations of the State of New York or of any municipal corporation or political subdivision of the State of New York (but interest on the obligations of other states and their political subdivisions is taxable).

Interest on bonds of the state of New Jersey, for instance, is taxable under the New York law, but exempt under the federal law.⁴

4. Interest on bonds or other obligations on which the investment tax was paid to the State of New York between June 1, 1917, and May 14, 1919, only during the period of years for which such tax shall have been paid.

Such interest is taxable under the federal law, but not taxable under the state law.⁵

¹See Chapter III.

²See *Income Tax Procedure*, 1921, page 524.

³Section 213 (4-d).

⁴See *Income Tax Procedure*, 1921, page 524.

⁵See Chapter III.

By a special section in the state law,⁶ non-residents are not taxed on "interest on bank deposits, interest on bonds, notes or other interest-bearing obligations except to the extent to which the same shall be a part of income from any business carried on in this state." For non-residents, see Chapter XVIII.

LAW. Section 359. The term "gross income":

1. Includes gains, profits and income derived from interest.

Interest accrued but not collected.—

REGULATION. Where interest coupons have matured, but have not been cashed, such interest, though not collected when due and payable, is nevertheless available to the taxpayer and should therefore be included in his gross income for the year during which the coupons matured unless the debtor be in default. This is so although the coupons are exchanged for other property instead of eventually being cashed. . . . (Art. 46.)

The state has improved upon the corresponding federal ruling⁷ by adding at the end of the first sentence the words "unless the debtor be in default." Obviously, if there is no reasonable chance of collecting the interest, it is not "available."

Accrued interest returned as income which is not subsequently collected.—If taxpayers reporting on the accrual basis have reported interest as it accrued and find that the debtor is unable to pay, they should charge off the amount as soon as it is known to be worthless and deduct it in their returns.

Interest accrued prior to January 1, 1919, not taxable.—The following ruling enunciates the same principle as that contained in the federal ruling,⁸ i.e., all interest accrued prior to the incidence of the tax law is not taxable, even though collectible subsequently.

⁶Section 359, 3.

⁷Reg. 45, Art. 54.

⁸Reg. 45, Art. 87.

RULING. In reply to your letter of January 21st, inquiring as to the taxability of interest accrued prior to January 1, 1919, but received after that date, you are advised that all interest whether on coupons or registered bonds, or any other interest-bearing obligations, which accrued prior to January 1, 1919, is exempt from taxation under the State law, even though received after that date, irrespective of whether the due date of interest payment is January, 1919, February, 1919, March, 1919, or any later date.

Our regulations regard all interest accrued up to January 1, 1919, as part of the capital of the taxpayer on that date, and exempt from taxation. (Letter to The Corporation Trust Company, signed by Eugene M. Travis, Comptroller, by Mark Graves, Director, Income Tax Bureau, and dated January 29, 1920.)

Interest on obligations on which tax was paid under the mortgage tax and secured debts laws.—By the payment of a fixed sum it was possible to secure exemption from taxation of interest on mortgages and other securities under the mortgage tax and the secured debts laws of the state of New York. The present investment tax law took the place of the secured debts law. The state income tax law provides for exemption of interest on investments on which the tax was paid under the investment tax law after June 1, 1917; but no provision is made for exempting the interest from mortgages on which a tax was paid to secure exemption under the mortgage tax law nor for exempting interest on securities under the old secured debts law. The interest on such securities is taxable.⁹

Interest on obligations of states and political subdivisions.—The state law taxes interest on obligations of states and political subdivisions¹⁰ thereof, except those of New York, but the federal law exempts such interest of all the states.¹¹

INTEREST ON AWARDS BY STATE OR MUNICIPALITY.—It has been held under a federal ruling¹² that bonds issued by a muni-

⁹Attorney-General's Income Tax Letter No. 8, see page 45.

¹⁰For definition of political subdivision, see article 74, page 42.

¹¹Federal law, section 213 (b-4).

¹²See *Income Tax Procedure*, 1921, page 507.

cipality covering deferred instalments of assessments against real estate for the cost of public improvements, although not a general liability of the city, were issued for public purposes and hence were obligations of a "political subdivision," and as such the interest on them was exempt.

The liability of a city to pay for property taken under the power of eminent domain is certainly an obligation. State constitutions provide that private property shall not be taken for public use except upon just compensation paid or secured.

Interest from miscellaneous sources.—There are very few interest problems which involve any difficulty. Interest which is not taxable is well defined. Practically all other interest is easily classified.

INTEREST ON BANK DEPOSITS.—

REGULATION. . . . Interest credited on savings bank deposits, even though the bank nominally has a rule, seldom or never enforced, that it may require a stipulated number of days' notice in advance of cashing depositors' checks, is income to the depositor when credited. . . . (Art. 46.)

INCOME OF BANKS FROM DISCOUNT AND INTEREST ON LOANS.—The method suggested by the Comptroller of the Currency, i.e., to credit all discount and interest collected in advance to an unearned account and to credit discount earned account with the amount actually earned, is the proper basis for reporting the amount of interest income for tax purposes.¹⁸

INTEREST CHARGED TO CONSTRUCTION.—A mere book entry, for statistical purposes, charging construction account and crediting income account with interest, does not result in taxable income. Subsequently, however, interest if so debited must be eliminated in determining profit or loss in realization.

Income from bonds paid at maturity or before.—If it is the practice of a taxpayer keeping accounts on an accrual basis to

¹⁸See *Income Tax Procedure*, 1921, page 508.

enter annually as income a proportional part of the difference between cost and par value of securities and to return such accruals for income tax purposes, it is proper to do so. When the bonds are paid at maturity or called, the amount to be returned will be only the difference between cost, or value January 1, 1919, plus the amounts previously returned (excepting interest actually collected) and the amount received.

When the amount received is less than cost or value January 1, 1919, plus the amounts returned as income, the difference is an allowable deduction as a loss.¹⁴

Interest received by stock-brokers and others.—Interest charged by stock-brokers and others, who in the ordinary course of business make regular interest entries against customers' accounts, should be reported in income tax returns at the gross amount so accrued or collected, and not at the net amount ascertained by deducting interest paid.

Interest on securities acquired between interest dates.—When securities are purchased between interest dates and the buyer pays to the seller an amount equal to the accrued interest between the last interest date and the date of sale, each should enter as income the portion of the interest assignable to the period during which he owned the security.

Income from life insurance policies.—The state law,¹⁵ like the federal law,¹⁶ exempts from income taxation the entire proceeds of life insurance policies¹⁷ upon the death of the assured when paid to individual beneficiaries or to the estate of the assured.

When premiums are paid they do not constitute an allowable deduction, but are treated as capital payments. Therefore

¹⁴See *Income Tax Procedure*, 1921, page 815.

¹⁵Section 359, 2,a.

¹⁶Federal law, section 213 (b) (1).

¹⁷See page 38.

the return of all or any part of such capital could not be taxed under an income tax law. If the assured receives at the expiration of a policy on the endowment plan, or from its cancellation, any amount in excess of premiums paid, such receipts are taxable income and must be returned.

The state, however, recognizes the value of the endowment contract at January 1, 1919. (See article 72, page 38.)

REGULATION. . . . Where an insured receives under life insurance, endowment or annuity contracts sums in excess of the premiums paid therefor, such excess is income for the year of its receipt. Distributions on paid-up policies which are made out of earnings of the insurance company are in the nature of corporate dividends and as such are income of an individual subject to the tax. (Art. 40.)

The foregoing regulation is similar to the federal ruling¹⁸ with the exception that the dividends mentioned in the last sentence are exempt from federal normal tax. The state law has no similar exemption.

Sinking fund investment.—As there is now no limitation on the deduction of interest paid, it is immaterial under the federal law how the interest is reported in the case of a corporation which has purchased its own bonds and holds them in the sinking fund. Corporations are not subject to state income tax, but the following ruling seems to have confused a situation such as that mentioned with the case in which certain sums are set aside in a sinking fund and invested in income-producing securities.

RULING. Our partnership was organized in 1920. It was necessary to borrow \$100,000 to start business. In order to meet this obligation due in 1925, we set aside from our earnings in 1920 the sum of \$20,000, which was invested in securities which yielded 7 per cent return. Is the interest from this sinking fund investment income taxable to the partnership?

Yes, on the assumption that the fixed retirement of \$20,000 annually is to be made to meet the obligation at maturity. If, on the other hand, the annual amount set aside for this reserve is computed to include the interest on the amount retired, such interest

¹⁸Reg. 45, Art. 47.

would not be taxable income to the partnership as it would be considered a capital investment for the retirement of the obligation at maturity. (Question 99, Comptroller's Questions and Answers, 1921.)

In the opinion of the author such interest is taxable in all cases.

Income from building and loan associations.—

REGULATION. . . . An amount credited to shareholders of a building and loan association, when such credit passes without restriction to the shareholder has a taxable status as income for the year of the credit. Where the amount of such accumulation does not become available to the shareholder until the maturity of a share, the amount of any share in excess of the aggregate amount paid in by the shareholder (or value on January 1, 1919, plus subsequent payments) is income for the year of the maturity of the share. (Art. 46.)

The state regulation recognizes values at January 1, 1919, when the shares were issued prior to that date.

Shares in many building and loan associations are not of the same nature as shares in corporations. No dividends are declared, but earnings are ascertained and are fully apportioned pro rata to the outstanding stock. So far as the books of the associations are concerned, an actual distribution is made and no surplus account is carried.

The accruing annual income from building and loan association shares and from life insurance policies is in the nature of interest earnings, as the funds are invested almost entirely in bonds and mortgages. They are formed on the mutual plan so that each stockholder or policyholder is in effect realizing annually his pro rata share of the entire net income.

Annuities.—

REGULATION. Annuities paid under an annuity contract are subject to tax to the extent that the aggregate amount of the payments to the annuitant exceeds any amounts paid by him as consideration for the contract. An annuity charged upon devised land is income taxable to the annuitant, whether paid by the devisee out of the rents of the land or from other sources. The devisee is not

required to return as taxable income the amount of rent paid to the annuitant, and he is not entitled to deduct from his taxable income any sums paid to the annuitant. . . . (Art. 40.)

When the annuity is a gift, however, the capital value of the annuity at the date of the gift would have to be returned to the annuitant before any income would be taxable. Also the value of the annuity on January 1, 1919, is to be considered.

RULING. An annuity of \$5,000 was provided for in a pre-nuptial contract to be charged upon real estate of a resident, and also an additional annuity of \$2,500 both payable to the wife of the maker. He has since died and she will receive during the calendar year 1920 the sum of \$7,500 from these grants. Are such amounts taxable to her as a resident of the State?

The annuitant should return as taxable income the \$7,500 which she will receive during her taxable year, or such amount thereof as is in excess of the fair market value of such annuity on January 1, 1919, less the amount received during the calendar year 1919. Annuities are income and are subject to tax in full, except that payments of such annuity to the amount of the fair market value on January 1, 1919, are assumed to be return of capital and to that extent not subject to tax. (Question 3, Comptroller's Questions and Answers, 1921.)

When the computation involves annuities effective after January 1, 1919, the allocation between capital and income is based on the fair market value of the annuity at the date of gift.

The following illustrates the distinction between "cost" and value at January 1, 1919.

RULING. An annuity contract was purchased by "A" sometime prior to January 1, 1919. On that day the payments received had already equalled the cost of such annuity. Are the annual payments received subsequent to January 1, 1919, income, which is taxable under the law?

Yes, except that the annuity contract has a determinable market value as of January 1, 1919, the subsequent payments not in excess of the fair market value as of that date are return of capital and as such not taxable, but any excess over the fair market value as of January 1, 1919, is taxable income. (Question 21, Comptroller's Questions and Answers, 1921.)

Deduction in case of tax-free covenant bonds.—Many corporation bonds contain a covenant by which the corporation agrees to assume and to pay any tax it may be required to withhold from the owners of the bonds. Section 221 (b) of the federal law requires in such cases that 2 per cent of the interest be deducted and withheld. There is no similar provision in the state law. Section 221 (d) of the federal law provides that any tax withheld “shall be credited against the amount of income tax as computed in such return.” The state law [section 366 (4)] reads exactly like the federal law, but as no withholding of 2 per cent of interest is required by the state the provision for credit does not apply to bond interest, but to other kinds of withholding which are required by the state law, e.g., withholding from personal service compensation of non-residents.¹⁹

The state, however, follows the federal practice in requiring that such tax “withheld” be reported as income.

REGULATION. . . . The amount of Federal or State income tax paid for or to a bondholder by an obligor pursuant to a tax-free covenant in its bonds is in the nature of additional interest paid the bondholder and must be included in his gross income. He is not, however, entitled to deduct such income tax paid on his behalf. . . . (Art. 21.)

To the federal ruling²⁰ the state has added the words “or to” before “a bondholder,” evidently to cover cases in which the corporation, not being required to withhold the tax under the state law, might make payment to the bondholder of a sum to reimburse him for the tax he has to pay on the interest.

Is tax “withheld at the source” income?—As under the state law, in contrast with the federal law, no provision is made for crediting the tax withheld on “tax-free covenant” bond interest, it is difficult to see how it can be held to constitute income to the bondholder.²¹

¹⁹See page 133.

²⁰Reg. 45, Art. 31.

²¹See *Income Tax Procedure*, 1921, pages 516-522.

RULING. In Section 385, it is expressly provided that any contract or agreement to pay, assume or bear the burden of any tax payable by a taxpayer shall be null and void and given no force or effect by any court.

You will, therefore, observe that bonds containing a covenant making them free from New York State Income Tax is without force and effect, and the interest income is taxable the same as from any other bonds. It is true that under the federal law, taxpayers receiving interest on tax-free covenant bonds are entitled to a credit against their tax; two per cent of the amount of interest, if the obligor corporation pays the tax to the federal government. The State law does not provide for the payment of tax at the source by the corporation so, of course, there is no such credit allowed on the State return. (Official ruling, dated January 19, 1920.)

The foregoing refers only to bonds containing a covenant making them free from New York State income tax. The state, however, attempts to treat the federal tax paid by obligor corporations as constructive income to the obligee. The owner of a \$1,000 tax-free covenant 6 per cent bond receives \$60 a year—no more and no less. The obligor pays \$1.20 thereon to the federal government. The recipient taxpayer deducts \$1.20 from his tax. In the opinion of the author the deduction of \$1.20 is in lieu of the payment by the obligor and no further accounting is called for by the law; but the federal regulations require the taxpayer to enter the \$1.20 as additional taxable income.

Under the state law the obligor does not pay the \$1.20 and the taxpayer does not deduct it from his tax. Therefore, the following instructions for reporting the amount of tax paid, which appears on page 2 of instructions, form 201, would seem to be unnecessary and misleading:

INSTRUCTION 22—INCOME FROM INTEREST

Report in Item 22(b) the amount of tax paid for, or reimbursed to, taxpayer by debtor corporations on bonds containing tax-free covenant.

As the obligor corporations have paid no tax for nor reimbursed any tax to the taxpayer, there would seem to be nothing to report.

Income From Royalties and Patents

Royalties and similar sources of income are mentioned in the state regulations, as in the federal,²² although not specifically mentioned in the law.

REGULATION. . . . Royalties on patents and copyrights are income. (Art. 42.)

One of the inequities of the law is the taxing of an inventor or author on the entire amount realized in one year, which often represents the result of years of study and experiment, instead of permitting such income to be prorated over a longer period.

Royalties from mines, oil wells, etc.—

ROYALTIES SUBJECT TO DEPLETION CHARGES.—The Comptroller has ruled²³ that deductions for depletion will be based on federal Regulations 45 (except that value at January 1, 1919, is to be used in certain cases instead of March 1, 1913) until the state issues specific rulings on the subject.²⁴

The owner of a mine, an oil well or other similar property operated on a royalty basis must return as income his royalties received, but is permitted to deduct expenses and to charge against receipts depletion allowances based on the full value of his property at January 1, 1919, if purchased before that date, or on the basis of the capital originally invested if purchased thereafter, except in the case of mines and oil wells discovered by the taxpayer in which case the value of the property at the date of discovery or within thirty days thereafter is the basis prescribed by law.²⁵

After the value at January 1, 1919, has been determined, a proper calculation must be made as to how much of the royalties received is capital and how much income. The part

²²Reg. 45, Arts. 48 and 541.

²³Article 190; see Chapter XV.

²⁴For detailed rulings and procedure, see *Income Tax Procedure*, 1921, Chapter XXXI, "Depletion."

²⁵Section 360, 9.

which is capital cannot be taxed, but all royalties which accrue must be reported as gross income and the depletion allowance must be deducted in order to ascertain the taxable or net income.

The essence of the federal rulings on this subject is that a deduction for depletion is allowed to the lessor against the royalties paid in advance, but if the lessor repossesses the property and the number of units taken out is less than that for which payment has been made, the depletion deductions applicable to the royalties on unextracted units must be returned by the lessor in the year of such repossession.²⁶

When royalties were waived for several years, because the mine was operated at a loss, and such royalties were all received in one year, full depletion applicable to such income was permitted as a deduction in the year in which the royalties were received.

Royalties from copyrights.—An author should report in gross income all sums received for copyright privileges. He is entitled to claim as deductions all expenses, except ordinary living expenses, incurred in producing the income.

REGULATION. . . . Amounts expended for securing a copyright and plates, which remain the property of the person making the payments are investments of capital. . . . (Art. 125.)

Deduction for depreciation of such items, however, should be made up to 100 per cent.²⁷

Profit from the sale of copyrights is computed in the same way as profit from the sale of patents.²⁸

Profits from patents.—No tax can be imposed on receipts from the sale of patents or patent rights unless the owner has made full provision to reimburse himself for the cost or value of them. If the patents were applied for or owned on or

²⁶For detailed discussion, see *Income Tax Procedure*, 1921, pages 489-492.

²⁷See Chapter XV.

²⁸See below.

before January 1, 1919, their actual value at that date is their capital value. If acquired after that date, the cost is considered the capital value.

Damages received for infringements of patents.—If the capital value has been diminished by the infringement the amount collected or any part thereof should be applied in reduction of the book value of the patents.

REGULATION. . . . a person may sue in one year on a pecuniary claim or for property, but money or property recovered on a judgment therefor rendered in a later year would be income in the year in which received assuming that it would have been income in the earlier year if then received. This is true of a recovery for patent infringement. . . . (Art. 44.)

However, the fair value of a claim on January 1, 1919,²⁹ is important. If a taxpayer was entitled to property in 1918, but did not recover it until 1920, it cannot be held that he received taxable income in 1920.

Patent development costs.—If a patent is not yielding satisfactory results, the cost of development should be charged off as an expense. When the results are doubtful it is proper either to capitalize or to charge off the amount. If written off, however, and the patent is subsequently sold, it may result in taxation of the entire purchase price.

PATENT LITIGATION EXPENSE.—Patent litigation expense should not be added to the cost, but should be deducted from income.

Method of valuing patents.—When a patent is transferred for compensation other than cash there should be taken into consideration at the date of the transfer the stage of the patent's commercial development, the degree of prosperity attained by the concern manufacturing it and any other facts which would serve to fix a fair value. Some of the informa-

²⁹For method of determining value at January 1, 1919, see page 208.

tion might appear to be of a later date, but it would be valuable in spite of that fact.

Value of patents at January 1, 1919.—Patents come within the category of depreciable assets because they are valuable for only a limited time. The monopoly granted by the government is for a specific period. It is, therefore, important to value patents correctly at January 1, 1919, in order to compute the proper depreciation deduction. The state regulation³⁰ differs from the federal ruling,³¹ in that the value at March 1, 1913, is to be used for patents acquired before that date.

In rare cases the value of patents can be established by sales of the particular patents at or about January 1, 1919. It is obvious that the value cannot be established by sales of similar property, because we are dealing with a monopoly. The law does not attempt to limit the 1919 value to "market" price at that time. Section 353, like the federal provision,³² reads "the fair market price or value of such property." There is no possibility in 99 out of 100 cases of ascertaining a "market price" at January 1, 1919, and it is needless to attempt it, because the law intends and authorizes taxpayers to determine the "value" of the patents at that date.

Testimony of witnesses qualified by their technical experience and knowledge to form a judgment as to the real value of such property is not only permitted by the courts but is required.³³

Patents not issued January 1, 1919, may be valued.—Applications for patents rank with those issued in ascertaining values of January 1, 1919. This is on the theory that there is an assignable property right in an application for a patent. Obviously if no patent is subsequently issued there will be no value at January 1, 1919.

³⁰Art. 174.

³¹Reg. 45, Art. 164.

³²Section 202 (a).

³³For court decisions, see *Income Tax Procedure*, 1921, pages 498-501.

When a patent was not issued until after January 1, 1919, the capital value should be spread over the period from January 1, 1919, to expiration date, which would be more than the customary 17 years.

Profits from sale of patents—how determined.—

REGULATION. A taxpayer disposing of patents or copyrights by sale should determine the profit or loss arising therefrom by computing the difference between the selling price and the value as of January 1, 1919, if acquired prior to that date, or between the selling price and the cost, if acquired subsequent to that date. The profit or loss thus determined should be increased or decreased, as the case may be, by the amounts deducted on account of depreciation of such patents or copyrights since December 31, 1918, or since the date of acquisition if acquired subsequent thereto. (Art. 32.)

The foregoing regulation is similar to the federal ruling,³⁴ excepting that instead of the dates January 1, 1919, and December 31, 1918, the federal dates are March 1, 1913, and February 28, 1913.

Income From Rents

The state law, like the federal,³⁵ specifically mentions rent as an item of income.

LAW. Section 359. The term "gross income":

1. Includes income derived from . . . rent

When books are kept on the accrual basis, all rents accrued should be reported. Any rents found to be uncollectible should be charged off as losses.

Permanent improvements by lessees.—

REGULATION. When improvements made by a lessee become part of the real estate, the value of such improvements upon the expiration of the existing term of the lease is income to the lessor. In general, sums paid by a tenant for the use of property, although to another than the landlord, are properly to be regarded as rent and constitute income of the landlord. . . . (Art. 42.)

The foregoing regulation is identical with the federal rul-

³⁴Reg. 45, Art. 40.

³⁵Federal law, section 213.

ing³⁶ before an amendment by the Treasury, presumably based on recent court decisions which have held that title to improvements paid for by lessees vests in lessors as soon as made. Since these decisions the Treasury holds that the lessors may be taxable at the time when the improvements are made. In the opinion of the author the decisions merely reiterate many other court decisions and restrict the Treasury in its attempt to tax what is not income.³⁷

It is not the "sums paid" which can be deemed to be taxable income to the lessor, but only the net value, if any, to the lessor. A lessee may have paid \$100,000 for improvements which revert to the lessor upon the expiration of the lease. The fair market value of the improvements is the measure of tax liability, without regard to the cost. If title passes when the improvements are made there is no taxable income, because the lessor realizes no income at that time and the improvements may be and frequently are worthless at the expiration of the lease.

Expenditures by lessees for taxes.—When leases between landlords and tenants stipulate that the latter shall pay taxes or make necessary repairs, expenditures of this character are considered as part of the rent and must be reported by the landlord.

REGULATION. . . . Taxes paid by a tenant to or for a landlord for business property are additional rent and constitute a deductible item to the tenant and taxable income to the landlord, the amount of the tax being deductible by the latter. . . . (Art. 120.)

In other words no taxable income arises from such payments, but it is proper that the items should be entered on both sides of the returns.

Rental of residence.—

RULING. During the summer a family home was rented for \$600.

³⁶Reg. 45, Art. 48.

³⁷For full discussion, see *Income Tax Procedure*, 1921, pages 549-553.

This compelled the taxpayer to pay out \$500 for the accommodation of a family in a residence elsewhere. Is the amount received as rental subject to reduction to the extent of the payment for housing the family elsewhere?

No. The whole \$600 must be reported as income. Such amount is clearly within the broad definition of income in section 359, which states that "the term 'gross income' includes gains, profits and income derived from salaries, wages or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property. . . ." (Question 15, Comptroller's Questions and Answers, 1921.)

The foregoing ruling shows the discrimination between the man owning his residence and the one who rents. So long as he occupies it as a residence, the former does not have to return the rental value; but the latter is not permitted to deduct the rent he pays. In the illustration given above, the taxpayer is actually only \$100 ahead, but must report \$600 as income. However, he may deduct depreciation as an expense for the time when the residence was rented to others.

The answer above, quoting section 359 in part, fails to quote the word in that section which does describe income of this character, viz., "rent."

Rent received other than in cash.—When the rental consists of a share of the crops, as in the case of some farm leases, the fair value thereof should be reported. The rental value of houses occupied by servants should be reported, as it is a saving in wages, which in turn is a reduction of personal or living expenses.

Income From Dividends

Taxation of dividends under the state law differs from the taxation of such income under the federal law in the following respects:

1. The definition of "dividend" differs under the two laws, the state law³⁸ defining a dividend as "any distribution

³⁸Section 350, 8.

made by a corporation out of its earnings or profits to its shareholders," while the federal law³⁹ limits the distribution to earnings accumulated since February 28, 1913, in the case of ordinary corporations, and since February 28, 1913, and prior to January 1, 1918, in the case of personal service corporations.

2. As a result of the above definitions it is not necessary under the state law to know when the profits from which the dividends are paid were accumulated, but this is important under the federal law to determine whether or not they are taxable.

3. Under the state law, dividends are not "credited" for the purpose of a normal tax, as is the case under the federal law. Dividends under the state law are subject to the same rate of tax as other income.

Dividends are taxable.⁴⁰—

LAW. Section 359. The term "gross income":

1. Includes gains, profits and income derived from . . . dividends . . .

Owners of record liable for tax—exception.—Many stocks are owned by others than shareholders of record. In such cases the following regulation is of importance.

REGULATION. Dividends on stock of domestic corporations or resident foreign corporations are prima facie income of the record owner of the stock, and such record owner will be liable for any tax based thereon, unless a disclosure of the actual ownership is made to the Comptroller, which shall show that the record owner is not the actual owner and who the owner is and his address. (Art. 525.)

"Dividend" defined.⁴¹—

LAW. Section 350. . . .

³⁹Federal law, section 201 (a).

⁴⁰Dividends on stock of federal reserve banks are exempt; see page 48.

⁴¹To show the wide difference in the definitions under the two laws, the federal law is here quoted:

LAW. Section 201. "(a) That the term, dividend, when used in this title (except in paragraph (10) of subdivision (a) of section 234) means

8. The word "dividend" means any distribution made by a corporation out of its earnings or profits to its shareholders or members, whether in cash or in other property or in stock of the corporation.

As distinguished from dividends in liquidation, the distribution must be made "in the ordinary course of business."

REGULATION. Dividends for the purpose of the statute comprise any distribution in the ordinary course of business, even though extraordinary in amount, made by a domestic or foreign corporation to its shareholders out of its earnings or profits. . . . (Art. 61.)

What constitutes a distribution?—The following is similar to the federal ruling,⁴² excepting that dividends declared payable to stockholders of record prior to the incidence of the tax law are exempt.

REGULATION. . . . The mere declaration of a dividend is not a distribution. Dividends are income for the year in which payable, regardless of when the earnings or profits out of which they were paid were accumulated, except that dividends declared payable to stockholders of record prior to January 1, 1919, are to be excluded from gross income even if received on or after January 1, 1919. . . . (Art. 61.)

The foregoing is important so far as the January 1, 1919, date is concerned, but in the case of stockholders reporting on a cash basis it is believed that no fault will be found with those who report dividends as of the date of receipt. Unless the tax rate be reduced the state will lose nothing by this method. If the tax rate is increased, as it probably will be, the state will benefit. If the rate is raised for 1922, as has been predicted, a taxpayer who receives dividends on January 2, 1922, payable December 31, 1921, and reports them as of the date of receipt will pay more tax than he would pay if the dividends were entered as of the date when payable.

(1) any distribution made by a corporation, other than a personal service corporation, to its shareholders or members, whether in cash or in other property or in stock of the corporation, out of its earnings or profits accumulated since February 28, 1913, or (2) any such distribution made by a personal service corporation out of its earnings or profits accumulated since February 28, 1913, and prior to January 1, 1918."

⁴²Reg. 45, Art. 1541.

Dividends declared prior to January 1, 1919.—An example of the kinds of dividends which are regarded as part of a taxpayer's capital at January 1, 1919, is given in the following.

RULING. In reply to your oral inquiry with reference to article 61 of the comptroller's income tax regulations, I have to say: Ordinarily a dividend is income to the stockholder for the year in which made payable, regardless of (a) the date when declared, (b) the date when received by the stockholder, and (c) when the earnings or profits out of which the dividend was paid were accumulated. There is one exception to this rule; that is: Dividends declared prior to January 1, 1919, to stockholders of record as of a date prior to January 1, 1919, are not to be included in the gross income of a taxpayer even if made payable on January 1, 1919, or subsequent thereto, or if received on that date or subsequent thereto.

For example, if the board of directors of the "X" company met on December 15, 1918, and declared a dividend payable to stockholders of record of December 30, 1918, payable on January 15, 1919, such dividend would be excluded from gross income and thereby free from tax. This is because the dividend having attached to the stock as of record on December 30, 1918, is a part of the capital of the stockholder of January 1, 1919, and free from tax as suggested. (Official-ruling, dated February 2, 1920.)

May a dividend be rescinded by directors or returned by stockholders?—If directors pay a dividend which proves to be unwise or excessive or illegal, and every stockholder agrees to return the amounts paid or credited, it may be expected that no court will hold that the payments represent income when received and capital payments when refunded, even though the dividends were paid or credited during one taxable year and the refunds occurred during the next year.

If the entire transaction occurred during the same taxable year it would not even appear in the returns or accounts of the taxpayer. In effect it would be a transaction marked "void."

Method of return of dividends from foreign corporations.—There is no provision in the state law as to residents similar to that in the federal law⁴³ permitting the amount of income

⁴³Federal law, section 222 (a). As to non-residents, see Chapter XVIII.

tax paid to a foreign country during the year to be credited against the income tax payable to the state. For example, receipt of a \$250 dividend from a British corporation would be entered in the federal return gross, \$357.14 (\$250, plus 30 per cent tax paid to the British government, \$107.14). Credit for the British income tax of \$107.14 would then be taken on the federal return against the total tax payable to the United States.

For state purposes the gross amount of the dividend should be returned as taxable income, because the gross amount of the dividends is apportioned to the individual stockholder and the British tax is in effect assessed against the individual. There is no provision which permits the income tax to be deducted from the income shown by the return. Therefore, although the dividend received amounts to only \$250, there is nothing in the law which permits the net amount to be reported as income.

Distributions received from personal service corporations.

—Dividends from personal service corporations are taxed under the state law like dividends from other corporations. Under the federal law distributions from earnings of such corporations accumulated since February 28, 1913, and prior to January 1, 1918, are taxed as dividends, and beginning January 1, 1918, personal service corporations are treated as partnerships and profits taxed to individual stockholders.

RULING. If an architect received during 1919 certain income from a personal service corporation, should he report it as partnership income?

No. The distributive income of personal service corporations is not taxable as partnership income in the manner outlined in the federal statute. A member of the personal service corporation should return as income in his personal return under the New York law, the amount of dividends, salary or other distribution of the earnings of the corporation received by him during his taxable year. Under the New York personal income tax law personal service corporations are not considered as partnerships. (Question 6, Comptroller's Questions and Answers, 1921.)

Taxability of dividends on national bank stock.—

RULING. I have examined the correspondence between the Income Tax Bureau and the St. Louis Union Trust Company, in which that Company questions the right of the State of New York to levy an income tax upon income derived from dividends on stock of national banks.

It is conceded that stockholders in National banks may be subjected to a property tax upon their stock. A tax on income from stock is either a tax on property (*Pollock v. Farmers' Loan and Trust Co.* 157 U. S. 429, 158 U. S. 601) or it is a tax against the person. If a tax against the person, the State of a man's residence has jurisdiction to impose the tax through its power over his person.

"Governmental jurisdiction in matters of taxation, as in the exercise of judicial function, depends upon the power to enforce the mandate of the State by action taken within its borders, either *in personam* or *in rem* according to the circumstances of the case, *as by arrest of the person . . .*" (from *Shaffer v. Carter* decided by U. S. Supreme Court March 1, 1920 [252 U. S. 37]).

The State of New York has power (enforceable by arrest) to tax its residents on income from sources without the State. The only possible limitation on this power is that the State shall not interfere with the functions of the Federal Government (*McCulloch v. Maryland* 4 Wheat 316). If the taxation of residents on their stock in National banks does not interfere with the functions of the Federal Government, I fail to see how the taxation of their income from such stock can do so. There is no question that New York could tax its residents on their stock in National banks, located within or without the State. (cf. *Hawley v. Malden* 232 U. S. 1.)

Where a state levies a tax on net incomes generally (less specified exemptions), it is doubtful whether the courts will look to the source of items of gross income for the purpose of saying whether or not jurisdiction exists to impose the tax (cf. *Peck & Co. v. Lowe* 247 U. S. 165; *U. S. Glue Co. v. Oak Creek* 247 U. S. 321); but it is more likely that they will look only to the power of the State to enforce its mandate within its borders. (*Shaffer v. Carter* supra.)

The question of power to tax nonresidents on income from National Bank stock does not concern us, for the statute specifically exempts nonresidents from taxation on income from stock (except where it is part of a business carried on within the State).⁴⁴

My conclusion is that income of residents, derived from dividends on the stock of National Banks (wherever situated) should

⁴⁴See Chapter XVIII.

be included in "gross income," in their returns. (Attorney-General's Income Tax Letter No. 27, dated March 31, 1920.)

Taxes on bank stock mentioned in the fourth paragraph above should be reported in the federal return as additional dividends. They will be deducted as taxes. Thus the taxpayer will save the normal tax on the amount involved. For state purposes, this is immaterial, as there is no "credit" against income for dividends.

Dividends paid in property.—

REGULATION. Dividends paid in securities or other property (other than its own stock), in which the earnings of a corporation have been invested, are income to the recipients to the amount of the fair market value of such property when receivable by the stockholders. . . . (Art. 62.)

When a dividend other than cash or stock is received, it should be returned for taxation at its cash value. If its equivalent cash value cannot be ascertained at time of receipt it should be returned when and if cash value can be determined.

Dividends paid in stock of another corporation.—

REGULATION. . . . A dividend paid in stock of another corporation is not a stock dividend. Where a corporation declares a dividend in stock of another corporation, setting aside the stock to be so distributed and notifying the stockholders of its action, the income arising to the recipients of such stock is its fair market value at the time the dividend becomes payable. . . . (Art. 62.)

The question of "crediting" for normal tax an amount greater than the book value when the market value is higher, which arises under federal practice, does not have to be considered for state purposes.

Dividends paid in Liberty bonds and other government securities.—

RULING. Answering your inquiry of November 24, you are advised that where dividends are paid in Liberty Bonds the amount to be returned as income is the fair market value of the Liberty

Bonds so received at the time the dividend is made payable. Dividends are to be returned as income at the time made payable rather than at the time when actually received. (Official ruling, dated November 29, 1919.)

Dividends paid in bonds which sell at a considerable discount should be entered by the recipients at the market value of the securities received. If the securities are subsequently sold at a lower price, credit may be claimed for the loss sustained. If sold at a higher price, the profit realized should be reported.

The ruling quoted above, on the principle of "constructive receipt," requires taxpayers even though reporting on the cash basis to report dividends in the period in which they are made "available," although they may not actually be received until the following year.⁴⁵

Scrip dividends.—

REGULATION. . . . Scrip dividends are subject to tax in the year in which the warrants are issuable to the stockholders. (Art. 62.)

Such dividends should be reported at their cash value. For a person reporting on the basis of cash receipts, the safer method in the case of receipt of scrip of doubtful character or scrip which has no active market would seem to be to wait until something more substantial than a "scrap of paper" is received.

SCRIP DIVIDENDS REDEEMABLE IN CASH OR STOCK.—When scrip dividends are issued with an option to redeem them in cash or stock no liability is created, the only entries in the books being a debit to surplus and a credit to "scrip dividend payable." Therefore no tax can be imposed at that point, because no asset of any kind has been segregated or distributed. It is, in effect, merely a suspense account. If any stockholder takes cash, there is to that extent only a diminution of assets and a distribution. When all stockholders take stock there is

⁴⁵See page 254.

no distribution, but there is a transfer from surplus to capital, and all the elements of a stock dividend are present.

Dividends declared from depreciation and depletion reserves.—There has been question as to the taxability of dividends declared from depreciation and depletion reserves, from appreciation of goodwill, from capital surplus and upon the liquidation of a corporation, etc. The general principle of the state law, as of the federal law, is that dividends must be paid from profits.⁴⁶ Any distribution which in fact is not from profits, but is a return of capital, even though it may be called a "dividend," is not taxable.

REGULATION. A reserve set up out of gross income by a corporation and maintained for the purpose of making good any loss of capital assets on account of depletion or depreciation is not a part of its surplus out of which ordinary dividends may be paid. A distribution made from such a reserve will be considered a liquidating dividend and will constitute taxable income to a stockholder only to the extent that the amount so received is in excess of the cost or fair market value as of January 1, 1919, of his shares of stock. No distribution, however, will be deemed to have been made from such a reserve except to the extent that the amount paid exceeds the surplus and undivided profits of the corporation. In general, any distribution made by a corporation other than out of earnings or profits is to be regarded as a return to the stockholder of part of the capital represented by his shares of stock, and upon a subsequent sale of such stock his profit will be the excess of the selling price over the cost of the stock or its fair market value as of January 1, 1919, after applying on such cost or value the amount of any such capital distribution. (Art. 66.)

The foregoing regulation differs from the corresponding federal ruling⁴⁷ on two important points:

1. Under the state ruling all profits must be distributed before a distribution from the reserve can be regarded as a return of capital. Under the federal ruling, after the profits since February 28, 1913, have been distributed, all further distributions may be considered as return of capital.

⁴⁶Section 350, 8.

⁴⁷Reg. 45, Art. 1549.

2. The state requires valuation of the stock at January 1, 1919, if acquired prior thereto. The corresponding federal date is March 1, 1913.

When corporations notify their stockholders that parts of the dividends are from depletion reserves, the stockholders of such corporations may naturally assume that the earned surplus of the corporations has been exhausted and that the dividends are in fact from depletion reserves. When such dividends are received they should be entered by the recipients as receipts of capital and should not be reported as taxable dividends.

Liquidation dividends.—The state law does not contain a specific provision regarding “amounts distributed in liquidation,” as does the federal law,⁴⁸ but the state has issued the following regulation on the subject, which is the same as the federal excepting that January 1, 1919, is the date used in place of March 1, 1913, and no reference is made to “surplus earned since February 28, 1913,” as under the state law this is not a factor in determining the taxability of dividends.

REGULATION. So-called liquidation or dissolution dividends by corporations during dissolution are not dividends within the meaning of the statute, and amounts so distributed are to be regarded as payments for the stock of the dissolved corporation. Any excess so received over the cost of his stock to the stockholder, or over its fair market value as of January 1, 1919, if acquired prior thereto, is a taxable profit. A distribution in liquidation of the assets and business of a corporation, which is a return to the stockholder of the value of his stock upon a surrender of his interest in the corporation, is distinguishable from a dividend paid by a going corporation out of current earnings or accumulated surplus when declared by the directors in their discretion, which is in the nature of a recurrent return upon the stock. (Art. 65.)

Dividends on life insurance policies.—So-called dividends declared by life insurance companies on certain classes of unmatured policies are in fact reductions of premiums and are

⁴⁸Federal law, section 201 (c).

not taxable. As a rule policyholders deduct the amounts of such so-called dividends from the premiums payable, but even if dividends are drawn in cash by the insured, such items, unless received on paid-up policies, do not constitute taxable income and should be excluded from returns.

Dividends paid from funds derived from tax-exempt securities.—

REGULATION. . . . Although interest on United States bonds and certain other obligations is not taxable when received by a corporation, upon amalgamation with other funds of the corporation such income loses its identity and when distributed to stockholders in dividends is taxable to the same extent as other dividends. (Art. 61.)

If the directors of a corporation desire its stockholders to receive the benefit of the exemption, it will be necessary first to distribute the securities to the stockholders. After distribution to individual stockholders the income will be entirely free from taxation.

Income From Stock Dividends

Following the decision of the Supreme Court of the United States⁴⁹ the Attorney-General of the state has ruled that stock dividends are not taxable.⁵⁰

RULING. . . . In 1913 the People adopted an amendment to the Federal constitution permitting the taxation of "incomes," and thereafter Congress passed several laws for the purpose. In 1919, the Legislature of New York passed an income tax law in practically similar phraseology (in this connection) as that of the later Congressional acts. While the intent of the Legislature was possibly to do just what Congress was *trying to do*, I think it much safer to say that the intent was to do just what Congress *was doing*. The Supreme Court has told us that Congress could not, and consequently did not tax stock dividends. I think that the Legislature,

⁴⁹*Macomber v. Eisner*, 252 U. S. 189, March 8, 1920. For full text of decision of court and minority opinion, see Corporation Trust Company 1920 Income Tax Service, pages 468-487.

⁵⁰[Former Procedure] A dividend paid in stock of the corporation issuing the dividend is income to the amount of the fair market value of the stock received as a dividend. (Art. 63.)

in levying a tax upon "incomes" intended to tax only those things which are commonly included in the term "income." And the Supreme Court has told us that stock dividends are not included within the commonly accepted meaning of that term.

In view of these facts, and the further fact that the Legislature is now in session and may promptly overrule me if it disagrees with my conclusion, I advise you that in my opinion the New York Income Tax Law (Tax Law, Art. XVI, added by L. 1919 C. 627) does not apply to true stock dividends, and they should not be included in taxpayers' returns as gross income.

Only "true stock dividends" are exempt.—

This only applies to what the Supreme Court terms "true stock dividends." It does not apply to dividends paid in stock of corporations other than those declaring them, nor to dividends paid in stock of the declaring corporation, purchased in the market for the purpose; but only to distributions of new or unissued stock to evidence the transfer upon the books of the company of items from surplus, undivided profits, or some similar account to capital account. (Attorney-General's Income Tax Letter No. 26, dated March 21, 1920.)

The statement in the foregoing ruling that "dividends paid in stock of the declaring corporation purchased in the market for the purpose" do not constitute stock dividends is erroneous. The essence of the Supreme Court decision is that the recipient of a true stock dividend does not receive "income"—his equity in the corporation is merely evidenced by more pieces of paper. This is exactly the position of a stockholder receiving a dividend in stock of the paying corporation, whether it is a new issue of stock or the corporation's stock purchased in the market and then distributed pro rata.

In considering the effect of the Supreme Court decision on stock dividends, the following quotation is of interest.

As to the states, *Eisner v. Macomber* appears to leave them free to include stock dividends in what they may call an income tax. While the Supreme Court explicitly disagrees with the reasoning of the Massachusetts court in *Tax Commissioner v. Putnam*,⁵¹ which held stock dividends taxable as income under the Massachusetts constitutional amendment, there is no hint that this judgment

⁵¹227 Mass. 522.

is reviewable by the Supreme Court. On the contrary, Mr. Justice Pitney says that "the Massachusetts court was not under an obligation, like the one which binds us, of applying a constitutional amendment in the light of other constitutional provisions that stand in the way of extending it by construction." If, as reported, the New York comptroller has ruled that *Eisner v. Macomber* operates to exclude stock dividends from the New York income tax, he seems to have been guilty of considerable presumption. The fact that the New York law adopts the interpretation of income contained in the federal law is not material, for there is no doubt that the federal law defined income so as to include stock dividends. The clauses of the Federal Constitution which this definition was held to offend do not limit the taxing powers of the states. The only protection which recipients of stock dividends could find in the Federal Constitution against state income taxation must be extracted from the due-process and equal-protection clauses of the Fourteenth Amendment. There are no decisions of the Supreme Court which proffer hope that these clauses would prove a shield.⁵²

Definition of stock dividends.—The definition given in the Attorney-General's opinion mentioned above is in the following words:

I have examined the opinions handed down on March 8, 1920, by the Supreme Court of the United States in the case of *Eisner vs. Macomber*.

The Court holds that a true stock dividend—when a corporation transfers amounts on its books from surplus or undivided profits accounts to capital account and distributes new or unissued stock among its stockholders, *pro rata*, to represent the amount so transferred—does not constitute "income" to the stockholders, within the meaning of that word as used in the Sixteenth Amendment to the Constitution of the United States.

The following transactions under the federal practice have been held not to constitute stock dividends:⁵³

1. When a corporation increases its capital stock and simultaneously declares a cash dividend equal in amount to the increase in its capital stock and gives to its stockholders a real

⁵²Thomas Reed Powell, "The Judicial Debate on Taxability of Stock Dividends as Income," *Bulletin of the National Tax Association*, May, 1920, page 256.

⁵³*Income Tax Procedure*, 1921, pages 599-600.

option either to keep the money or to reinvest it in the new shares.

2. When a corporation, which is not permitted under the laws of the state in which it is incorporated to issue a stock dividend, increases its capital stock and at the same time declares a cash dividend under an agreement with the stockholders to reinvest the money so received in the new issue of capital stock.

3. When a national bank declares a cash dividend coupled with the right to apply it to the purchase of additional capital stock.

National banks are authorized to issue only cash dividends.

Computation of profit or loss on sales of stock dividends or of stock upon which such dividends were declared.—The state and federal regulations have the same general rule for ascertaining costs of stock when both old and new shares are of the same class, viz., the cost of the old shares divided by the number of old and new shares gives the new cost of both old and new shares.

REGULATION. For the purpose of ascertaining the gain or loss derived from the sale of stock of a corporation, received from the corporation subsequent to December 31, 1918, as a dividend on its stock or from the sale of stock in respect of which such dividend was paid, the cost of each share of the old and the new stock is the quotient of the cost of the old stock or its value on January 1, 1919, if acquired prior thereto, divided by the number of old and new shares.⁵⁴ This regulation does not apply to dividends paid in shares of stock of a corporation other than the one declaring the dividend nor to dividends paid in shares of stock of the declaring corporation, if the shares were purchased as a medium of payment of the dividend.⁵⁵ (Art. 64.)

It is to be noted that the foregoing regulation is retroactive

⁵⁴[Former Procedure] This formerly read: "the cost of each share of new stock is the quotient of the sum of (a) the cost of the old stock or its value on January 1, 1919, if acquired prior thereto, plus (b) the valuation at which the new stock was returnable as income, divided by the number of old and new shares."

⁵⁵See page 259.

to 1919 returns. Stock dividends in that year under the law before amendment were reported at their market value at date of receipt; and this value was used in determining the cost of stock for purpose of computing profit or loss on subsequent sales. Claim for refund should be made, reducing the income by the amount reported as a dividend, and a new computation of profit or loss will have to be made in accordance with regulations quoted above.

WHEN SHARES ARE OF DIFFERENT CHARACTER.—The federal regulations contain a requirement, not found in the state ruling, in regard to computing cost for determining profit or loss on subsequent sale, when the stock issued as a dividend is of a character or preference materially different from the stock upon which the stock dividend is paid. In such case the cost of the old stock is divided between such old stock and the new stock, or classes of new stock, in proportion, as nearly as may be, to the respective values of each class of stock, old and new, at the time the new shares of stock are issued, and the cost of each share of stock will be the quotient of the cost of the class to which such share belongs divided by the number of shares in that class.

Of course, the resulting profit or loss, using such cost, will be different from that reported in the state return.

PURCHASES AT DIFFERENT TIMES AND DIFFERENT PRICES.⁵⁶—The state has not issued specific rulings requiring the allocation of stock dividends to particular lots of purchased stock when such purchased stock was bought at various times and various prices. The federal rulings have recently been amended, prohibiting, in such cases, a method of dividing the total cost of the purchased stock by the number of old and new shares. The general rule has been stated as follows:

Each share of dividend stock sold must be allocated to a particular lot of purchased stock and the basis for determining gain or

⁵⁶See *Income Tax Procedure, 1921*, pages 606-608.

loss upon the sale of any such stock shall be determined by using the cost of the shares to which such dividend share has been allocated. . . . If, however, the taxpayer is able to identify his various purchases, he may allocate, according to his wishes, the stock received as a dividend, except that no share of purchased stock may, for the purpose of this computation, be credited with more than its proportionate share of the dividend stock.

In computing the gain or loss upon the sale of the purchased stock it is held that the same basis must be used in each case as is used in computing the gain or loss resulting from the sale of dividend stock allocated to the particular lot of purchased stock which is sold.

Refund of taxes paid on stock dividends.—Claim for refund⁵⁷ of taxes paid on stock dividends should be made on form 110. On this should be shown the amount reported as income, and if any of the dividend stock or stock on which the dividend was declared has been sold, it will be necessary to include a recomputation of the profit or loss, as indicated on page 261.

Does stock dividend belong to life tenant or to remainderman?—In discussing the broad question of whether a stock dividend is income within the meaning of the law, an opinion of the Attorney-General states in part.

RULING. It is true that, as between life tenant and remainderman, the courts of New York (also Pennsylvania, California and other States—see dissenting opinion of Mr. Justice Brandeis in *Eisner vs. Macomber*) have held that stock dividends partake of the nature of capital, in so far as they represent earnings of the corporation prior to the creation of the life interest, and of the nature of income in so far as they represent earnings during the life estate. But this does not necessarily control in the construction of a law taxing incomes. For example, in Massachusetts the courts hold that as between remainderman and life tenant, stock dividends are capital (*Minot vs. Paine*, 99 Mass. 101), but they also hold, that for purposes of the income tax, they are income (*Tax Comm'r vs. Putnam*, 227 Mass. 552). For the purpose of the New York corporation franchise tax, our courts have held that stock dividends are “dividends,” by which the tax on the right to corporate existence is

⁵⁷See page 106 and Appendix A.

measured. (*Peo. ex rel Pullman Co. vs. Glynn*, 130 AD 332, aff'd 198 N. Y. 605; *Peo. ex rel Empire State Dairy Co. vs. Sohmer*, 216 N. Y. 199). But that indicates nothing with respect to the question of whether stock dividends are "income" to the shareholders receiving them. . . . (Attorney-General's Income Tax Letter No. 26, dated March 21, 1920.)

The United States Supreme Court⁵⁸ and a minority of state courts give it to the remainderman.

⁵⁸*Gibbons v. Mahon*, 136 U. S. 549.

CHAPTER XII

DEDUCTIONS FOR EXPENSES

The state law follows the federal law closely in its definition of deductible items. Broadly speaking, expenses incurred in the ordinary course of business can be deducted, but personal expenses are not deductible. The line of demarcation is often vague and in some cases the distinctions seem unfair, but in course of time it may be that apparent injustices will be rectified.

Capital expenditures as such are not allowed as deductions, but an allowance for depreciation, even of books, may be claimed.

Gifts, as distinguished from specific classes of donations, cannot be deducted.

Summary of Differences Between State and Federal Procedure

Expenses incurred in producing non-taxable income are held by the state to be non-deductible. There is no similar limitation under federal practice. (See page 266.)

Expenses incurred prior to January 1, 1919, are not deductible for state purposes, whether the taxpayer is on a cash or accrual basis, while for federal purposes such expenses are deductible. (See page 268.)

Traveling expenses, such as meals and lodgings, in excess of an allowance for same, are not deductible under state practice, but are deductible for federal purposes after adjustment for cost of such items at home. (See page 274.)

When gifts are made in property, the basis of the deduction is the market value of the property at date of the gift. The donor is also required to take up the appreciation in value of the gift as income. For federal purposes the basis of de-

duction for the gift is the cost of the property or its value at March 1, 1913 (if acquired prior thereto), less proper depreciation. (See page 282.)

Non-residents may deduct expenses only in connection with income arising from sources within the state. There is, of course, no similar restriction on non-resident citizens under the federal law, since their income from all sources is taxable. (See page 266.)

General

Expenses which are deductible.—

LAW. Section 360. In computing net income there shall be allowed as deductions:

1. **All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, ...**

REGULATION. Business expenses (whether subtracted from total receipts in computing gross income or deducted from gross income in computing net income) include all items entering into what is ordinarily known as the cost of goods sold, together with selling and management expenses, except such classes of items as are treated in articles 136-190 under "Deductions Allowed." Among the items to be treated as business expenses are material, labor, supplies and repairs in the case of a manufacturer, while a merchant would include his purchases of goods bought for resale. In either case the amount to be taken as a deduction in any year should be determined by taking into consideration the inventory at the beginning and end of the year. Other items that may be included as business expenses are reasonable compensation for the services of officers and employees, advertising and other selling expenses. A taxpayer is entitled to deduct all the ordinary and necessary expenses paid in carrying on his business from his gross income from whatever source. Expenses in earning income which is not taxable do not constitute allowable deductions in computing net income from other sources which are taxable under the law. In the case of a nonresident taxpayer the ordinary and necessary expenses which may be deducted are those paid in connection with income arising from sources within the state only. (Art. III.)

Section 360 (1) of the law is identical with section 214 (a-1) of the federal law, and in the main article III follows the federal article 101. There are, however, two outstanding provisions which differentiate the state and federal regulations.

The first is that "expenses in earning income which is not taxable do not constitute allowable deductions." This provision seems to be contrary to the provisions of the law. An investment in Liberty bonds or in municipal securities within the state of New York results in income which is not taxable. If the above regulation were applied, the interest on a loan to carry such securities would not be an allowable deduction. As such a provision is contrary to section 360 (2) of the law, it cannot be upheld.

The second is that a non-resident can consider as allowable deductions only the ordinary and necessary expenses connected with income arising from sources within the state. As applied to business expenses, this provision is doubtless equitable but it will conflict with section 360 (2) as to interest on loans to carry Liberty bonds and tax-free New York State securities.

The question may be raised as to whether the provision regarding non-residents is not discriminatory. A resident may deduct all taxes paid on his residence, interest on the mortgage covering his house and other expenses which are not in any way associated with the earning of taxable income. These deductions are not allowed to the non-resident under article III and this ruling is confirmed by the following:

RULING. Would a nonresident be allowed to deduct interest on indebtedness incurred in connection with a loan to build his private residence in New York City?

No. Such indebtedness is not incurred in connection with any taxable income of the nonresident from sources in New York state, in the absence of any facts showing that the owner has any intention of renting his home. (Question 52, Comptroller's Questions and Answers, 1921.)

Restrictions on expense deductions.—

LAW. Section 361. In computing net income no deduction shall in any case be allowed in respect of:

1. Personal, living, or family expenses;
2. Any amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate;

3. Any amount expended in restoring property or in making good the exhaustion thereof for which an allowance is or has been made; or

4. Premiums paid on any life insurance policy, covering the life of any officer or employee, or of any person financially interested in any trade or business carried on by the taxpayer, when the taxpayer is directly or indirectly a beneficiary under such policy.

This section of the law is identical with section 215 of the federal law.

Accrued expenses may be deducted.—A taxpayer who keeps his accounts on an accrual basis may deduct all expenses incurred during the taxable year, whether actually paid or not during such period. It is assumed, of course, that income will be accrued and as such reported in the tax return even if not actually received. If the return is on a cash basis, expenses must not be accrued.

The following ruling applies to expenses accrued prior to the incidence of the tax law.

RULING. In reply to your oral inquiry, let me say, that the rule with respect to the year in which deductions may be claimed or made is stated in Article 123 of our regulations. Expenses accrued prior to the incidence of the tax, that is, prior to January 1, 1919, may not be deducted from gross income for 1919, irrespective of the method of accounting employed by the taxpayer. In case interest is paid on an obligation for a year ended June 30, 1919, the taxpayer cannot deduct the total amount of interest paid. One-half thereof accrued prior to the incidence of the income tax and is not a proper deduction from gross income for 1919. In such a case one-half only of the interest is deductible. . . . (Official ruling, dated January 31, 1920.)

As the taxpayer would not include as income items earned prior to January 1, 1919, but received after that date, it is just that expenses which accrued prior to January 1, 1919, may not be deducted from 1919 income or income of later years, simply because the liability was liquidated subsequent to January 1, 1919. This procedure is confirmed by the Attorney-General's Income Tax Letter No. 42, dated February 4, 1921.

RULING. I have examined the question, raised by attorneys for two different taxpayers, which you have referred to me, of the de-

ductibility under subdivision 3 of Section 360 of the Tax Law of taxes accrued and payable prior to January 1, 1919, but actually paid thereafter.

The taxpayers in these cases, paid taxes in 1919 which were overdue—which had accrued and were payable in prior years. They deducted them in computing their net incomes for 1919. You ruled that these deductions were improper.

I consider your ruling quite correct. The income tax is based on a scheme which contemplates a fresh start on January 1, 1919. Income and increment was all considered accrued on that date—what had been income is regarded as having then become capital, in order that the tax will not be in effect levied on income accrued prior to January 1919 and that income coming into existence thereafter shall not escape taxation. The general plan is clearly indicated in such sections as 353, 355 and 360 paragraph 9, where the basis of ascertaining gains or losses is established as market value on January 1, 1919.

To my mind it is perfectly clear that the statute contemplated a general liquidation and balancing of books as of January 1, 1919. Items of income properly belonging to 1918 were to be regarded as capital on January 1, 1919. And similarly deductions, which on a proper accounting basis were chargeable against 1918 income, effected a reduction of capital as of January 1, 1919. In neither case should the items enter into income account for 1919, even if receipt or payment did happen to be delayed until that year.

You have ruled, and I believe correctly, that income earned and accrued in 1918, but not actually received until 1919, is not taxable as income for the year 1919. Similarly items which would have been proper deductions in computing profit and loss for 1918, should not be carried over and deducted from 1919 income.

The statute was drawn for permanent use—after a few years the situation on January 1, 1919, will cease to be a factor in computing current income taxes. So it would be a mistake to clutter up every section and subdivision with a specific reference to January 1, 1919.

Your correspondents insist that "Taxes, other than income taxes, paid or accrued within the taxable year" means all taxes paid within the year, regardless of date of accrual. They insist that there is no limitation by January 1, 1919 as in the case of gain or loss from sale of property. But if they are right, then it is also true of the items enumerated in subdivisions 1, 2, 7, and 8. If you permit the deduction of taxes which were due before January 1, 1919, you must also allow the deduction of old accounts for ordinary and necessary expenses, if paid after January 1, 1919 even if due years before then; you must allow the deduction of interest accrued in 1918 but not paid

until 1919 (and by the same token you must make the recipient thereof return it as 1919 income); you must allow the deduction of debts charged off in 1919 even if suspected of being worthless for years before, regardless of their actual value on January 1, 1919 and you must allow deductions for exhaustion, wear and tear, and obsolescence covering the period between the acquisition of any property (even if in 1890) and the end of the taxable year 1919. The absurdity is obvious.

I advise you to enforce the ruling first mentioned above until the courts hold otherwise. (Attorney-General's Income Tax Letter No. 42, dated February 4, 1921.)

Miscellaneous Business and Professional Expenses

Definition of "business or trade."—Although the law specifically refers to "expenses . . . in carrying on any trade or business," there has been only one ruling in which any attempt has been made to define the terms. Even that ruling¹ merely repeats part of the wording of the federal Treasury Decision 1989, dated June 2, 1914, which reads as follows:

That which occupies and engages the time, attention and labor of anyone for the purpose of livelihood, profit or improvement; that which is his personal concern or interest; employment, regular occupation, but it is not necessary that it should be his sole occupation or employment. (T. D. 1989, June 2, 1914.)

This definition is broad and will apply to persons who, although not in business on their own account, have expenses necessary to the performance of those duties which form the means of earning taxable income.

No official definition of personal expenses has yet appeared.

Professional expenses.—

REGULATION. A professional man may claim as deductions the cost of supplies used by him in the practice of his profession, expenses paid in the operation and repair of an automobile used in making professional calls, dues to professional societies and subscriptions to professional journals, the rent paid for office rooms, the expense of the fuel, light, water, telephone, etc., used in such offices,

¹See official ruling, dated March 27, 1920; page 272.

and the hire of office assistants. Amounts expended for books, furniture and professional instruments and equipment of a permanent character are not allowable deductions, but a proper allowance for the depreciation of such capital assets may be deducted. (Art. 114.)

The question as to what constitutes professional expenses within the meaning of the regulations has been much debated. If the term embraces expenses necessary to professional work, there is no reason why educational fees should not be permitted as a deduction. The expense of attending lectures on some special topic, a knowledge of which is vitally necessary to bring a practitioner's knowledge up to date, is one which is incurred in order to be capable of earning (taxable) income and for that reason might be considered deductible. In the following answer, the Comptroller permits a professional singer to deduct the cost of instruction and music, yet, on the other hand, similar expenses are denied to those in other professions.

RULING. If a professional singer includes the amount of her income from this source in the joint return filed by her husband, may she deduct railroad fare, cost of instruction and music from such amount?

Yes. These necessary expenses incurred in connection with this source of income are deductible. (Question 36, Comptroller's Questions and Answers, 1921.)

Membership fees in chambers of commerce by business and professional men.—

RULING. I have your letter of the 19th inst., wherein you inquire whether dues paid by business and professional men to the chambers of commerce are deductible expenses under the income tax law. In reply you are advised that such expenses are allowable deductions and may be included in other business expenses in computing the income subject to tax. (Official ruling, dated December 23, 1919.)

Membership fees in chamber of commerce by one not engaged in professional work or in business.—

RULING. Inasmuch as you are not in business, your membership fee in the Chamber of Commerce is not a deductible item. (Official ruling, dated January 16, 1920.)

Deductibility of dues and other amounts paid to labor unions and organizations by the members thereof.—

RULING. I have considered the argument contained in your letter of March 16, 1920.

Section 360 of the Income Tax Law provides that in computing net income there shall be allowed as deductions:

1. All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business.

The last two words are used synonymously and have been defined as that which occupies the time, attention and labor of anyone for the purpose of livelihood, profit or improvement. Therefore, there is no distinction between the employer and employee, or the worker as distinguished from the so-called business man. It is apparent that this distinction is broad enough to include professions as well as various avocations and side lines. Moreover it is not necessary for a person to own a business in order to be in business, to have business expenses. Salaried officers and employees and persons receiving their remuneration on a commission basis often have business expenses which are necessary and are allowable as deductions.

Section 361 provides that in computing net income no deduction shall in any case be allowed in respect of

1. Personal, living or family expenses.

In determining whether a particular item paid out by the taxpayer is deductible, the above sections of the law must be carefully considered. Section 360 has been given very liberal interpretation to the effect that dues paid by a taxpayer to any organization or association are allowable deductions when such organization or association is organized solely to promote the general business interests of the taxpayer as distinguished from the personal or social interests of the taxpayer. Certain organizations or associations clearly fall within this class, such as Chambers of Commerce, Business Leagues, Boards of Trade, and Medical and Legal Associations. Organizations which would not clearly fall within this class are social clubs, athletic clubs and fraternal organizations.

It follows that the test in any particular case is the purpose of the organizations and the benefits to be derived from membership in such organizations. Examination into the character and purpose of certain labor organizations discloses that the majority provided among other benefits, insurance against lay-offs, whether voluntary or involuntary, health, accident and disability insurance and pensions. Where this is true, the amount paid by the member is in the nature of a premium for insurance rather than a strictly membership due. As the amount received by the taxpayer in the form of insurance, in the case of accident, disability, death, etc., is not included as taxable income, the law strictly provides that any premiums paid therefor are

not deductible items of expense; and therefore any amount paid by the taxpayer for such purpose, whether a professional man, business man, worker, an employer or employee, is not deductible. The reason for this is that they are in the nature of personal, living and family expenses. Dues paid to labor organizations or associations organized to promote working conditions of its members, such as their working hours, salaries, etc., and which do not tend to decrease the member's personal, family and living expenses, are proper deductions.

I, therefore, conclude:

1. Dues to labor unions and organizations are deductible, where no part of such dues is applied toward insurance and personal benefits as specified in the last preceding paragraph.

2. If a part of the total amount of dues so paid is for insurance or personal benefits, then the portion representing the strictly membership due is deductible, if the amount thereof is calculable.

3. If no apportionment can be made as to the amount paid as a membership due, and the amount applied to insurance and personal benefits, then no part is deductible. (Official ruling, dated March 27, 1920.)

Dues to fraternal organizations and clubs.—

RULING. Dues paid to fraternal organizations and to clubs are regarded as personal expenses and are not deductible items. (Official ruling, dated January 12, 1920.)

However, the federal tax on club dues is deductible.

Miscellaneous business expenses of professional men.—

Expenditures on books are not deductible, but a claim may be made for depreciation, which in many cases will be greater than the cost of books added yearly to a professional library.

RULING. In addition to ordinary professional expenses, would an attorney be permitted to deduct any amount for depreciation on his law library?

Yes. This property is subject to depreciation and the attorney may claim as a deduction a reasonable amount as determined by the law and the rules and regulations of the Comptroller. (Question 34, Comptroller's Questions and Answers, 1921.)

See also article 114, page 270.

For the use of rooms in a residence for professional purposes a deduction may be made if the residence is rented, but not if owned by the taxpayer.

RULINGS. In the case of a minister renting a parsonage, is any amount of such rent deductible as a business expense?

Yes, the proportion which would properly be assigned to the minister's study or any room used by him solely in connection with his religious duties. (Question 40, Comptroller's Questions and Answers, 1921.)

If a man rents a piece of property which he uses both for residence and business purposes, may he deduct any amount on account of rent as a business expense?

Yes, an amount determined in the proportion that the space occupied by him for business purposes bears to the entire amount of space which he uses. (Question 68, Comptroller's Questions and Answers, 1921.)

If a physician uses two rooms in the residence owned by him, for private consultations, is the proportion of the amount of their rental value deductible as a business expense?

No, not in the case of property owned by the taxpayer. (Question 41, Comptroller's Questions and Answers, 1921.)

The foregoing ruling must be considered in conjunction with the allowable deductions of a physician. These include depreciation of the part of his residence used for his offices and all expenses connected therewith. In theory the deductions should equal the value of the rooms on a cost basis. If a higher basis were used the excess would have to be reported as taxable income and the net result would be the same.

Traveling expenses.—

REGULATION. Traveling expenses, as ordinarily understood, include railroad fares and meals and lodging. If the trip is undertaken for other than business purposes, such railroad fares are personal expenses and such meals and lodging are living expenses. If the trip is on business, the traveling expenses, including railroad fares, meals and lodging become business instead of personal expenses. (a) If, then, an individual whose business requires him to travel receives a salary as full compensation for his services, without reimbursement of traveling expenses, his traveling expenses are deductible from gross income. (b) If such individual receives a salary and is also repaid his actual traveling expenses, no part of such expenses is deductible from gross income and no part of such repayment is returnable as income. (c) If such an individual receives a salary and also an allowance for meals and lodging, as for example, a per diem allowance in lieu of subsistence, any excess of the cost of such meals and lodging over the allowance is not deductible, but any ex-

cess of the allowance over the actual expenses is taxable income. Any person who receives a mileage allowance for railroad fares should return as income any excess of such allowance over his actual expenses for such fares. A payment for the use of a sample room at a hotel for the display of goods is a business expense. (Art. 118.)

The above regulation should be amended, as far as (c) is concerned, to make it agree with the amended article 292 of the federal regulations. It is obviously unfair to require one man to return as income the excess of the allowance for meals and lodging over the actual cost, while another is not permitted to deduct as an expense the excess of cost over the allowance. For the benefit of their employees, employers should increase the salary of their traveling staff by the amount of the per diem allowance and denominate the total as "salary" so that an employee can deduct the whole of his traveling expenses under (a) above. This procedure is just and will be necessary only so long as the regulation remains unamended.

Salaries, Wages, Commissions and Similar Compensation

The law [section 360 (1)] permits a deduction of "a reasonable allowance for salaries or other compensation for personal services actually rendered."

The phraseology employed is identical with that in section 214 (a) of the federal law. In discussing the latter² the author has contended that the Treasury cannot substitute its judgment for that of directors and stockholders as to what is "a reasonable allowance." All that was said there applies with equal force to the state law and to the following regulation:

REGULATION. Among the ordinary and necessary expenses paid or incurred in carrying on any trade or business may be included a reasonable allowance for salaries or other compensation for personal services actually rendered. The test of deductibility in the case of compensation payments is whether they are reasonable and are in fact payments purely for services. This test and its practical application may be further stated and illustrated as follows:

²*Income Tax Procedure*, 1921, page 677 *et seq.*

(1) Any amount paid in the form of compensation, but not in fact as the purchase price of services, is not deductible. An ostensible salary may be in part payment for property. For example, an owner may sell a business to another, the seller agreeing to continue in the service of the purchaser. In such a case it may be found that the salary of the seller is not merely for services, but in part constitutes payment for the transfer of the business.

(2) The form or method of fixing compensation is not decisive as to deductibility. While any form of contingent compensation invites scrutiny as a possible distribution of earnings of the enterprise, it does not follow that payments on a contingent basis are to be treated fundamentally on any basis different from that applying to compensation at a flat rate. Generally speaking, if contingent compensation is paid pursuant to a free bargain between the enterprise and the individual made before the services are rendered, not influenced by any consideration on the part of the employer other than that of securing on fair and advantageous terms the services of the individual, it should be allowed as a deduction even though in the actual working out of the contract it may prove to be greater than the amount which would ordinarily be paid.

(3) In any event the allowance for compensation paid, to be deductible, may not exceed what is reasonable in all the circumstances. It is in general just to assume that reasonable and true compensation is only such amount as would ordinarily be paid for like services by like enterprises in like circumstances. The circumstances to be taken into consideration are those existing at the date when the contract for services was made, not those existing at the date when the contract is questioned. The father is legally entitled to the services of his unemancipated minor children and allowances which he gives them, whether such be in consideration of services or otherwise, are not allowable deductions in his return of income. (Art. 115.)

Treatment of excessive compensation.—

REGULATION. In the case of excessive payments by partnerships, the amounts disallowed should ordinarily be treated as shares of the profits of a partnership, except that a payment for property by an individual or a partnership should be treated by the individual or partnership as a capital expenditure and by the recipient as part of the purchase price. (Art. 116.)

Bonuses to employees.—

REGULATION. Gifts or bonuses to employees will constitute allowable deductions from gross income when such payments are made in good faith and as additional compensation for services actually ren-

dered by the employees, provided such payments, when added to the stipulated salaries, do not exceed a reasonable compensation for the services rendered. Donations made to employees and others, which do not have in them the element of compensation or are in excess of reasonable compensation for services, are considered gratuities and are not deductible from gross income. (Art. 117.)

Here again appears the qualifying "reasonable" as applied to compensation, justification for which does not seem to be forthcoming.

Pension payments.—

REGULATION. Amounts paid for pensions to retired employees or to their families or others dependent upon them, or on account of injuries received by employees, and lump sum amounts paid as compensation for injuries, are proper deductions as ordinary and necessary expenses. Such deductions are limited to the amount not compensated for by insurance or otherwise. No deduction shall be made for contributions to a pension fund held by the taxpayer, the amount deductible in such case being the amount actually paid to the employee. When the amount of the salary of an officer or employee is paid for a limited period after his death to his widow or heirs in recognition of the services rendered by the individual, such payments may be deducted. Salaries paid by employers during the continuance of the war to employees who are absent in the military or naval service or are serving the Government in other ways at a nominal compensation, but who intend to return at the conclusion of the war, are allowable deductions. (Art. 119.)

The provision limiting the deduction to the amounts actually paid from pension funds is not in accordance with the principle of accruing expenses. Employers having pension funds are presumed to set up an amount approximating their liability under the scheme and such amounts set aside should be permitted as deductions.

Gifts, Donations, Subscriptions and Contributions

The deduction of gifts and donations to certain specified types of corporations or associations is permitted by the state law much as similar deductions are allowed under the federal law. All gifts are not deductible and there is a restriction on the total amount which can be deducted.

Charitable, etc., contributions as deductible items.—

LAW. Section 360. . . .

10. Contributions or gifts, made within the taxable year to corporations or associations operated exclusively for religious, charitable, scientific or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private stockholder or individual, or to the special fund for vocational rehabilitation authorized by section seven of the act of congress known as the vocational rehabilitation act, to an amount not in excess of fifteen per centum of the taxpayer's net income as computed without the benefit of this subdivision. Such contributions or gifts shall be allowable as deductions only if verified under rules and regulations prescribed by the comptroller. . . .

REGULATION. Contributions or gifts within the taxable year are deductible to an aggregate amount not in excess of 15 per cent of the taxpayer's net income as computed without the benefit of this deduction, if made (a) to corporations or associations operated exclusively for religious, charitable, scientific or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private stockholder or individual, or (b) to the special fund for vocational rehabilitation under the Vocational Rehabilitation Act of June 27, 1918. A gift to a common agency for several such corporations or associations is treated like a gift directly to them. In connection with claims for this deduction there shall be stated on returns of income the name and address of each organization to which a gift was made and the approximate date and the amount of the gift in each case. Where the gift is other than money, the basis for calculation of the amount of the gift shall be the fair market value of the property at the time given, but the difference between such value and cost (or fair market value on January 1, 1919, if acquired before that date) shall be returned as profit or loss by the donor. A gift of real estate to a city to be maintained perpetually as a public park is not an allowable deduction. This article does not apply to gifts by partnerships or estates and trusts. (Art. 201.)

The provisions of section 360 (10) of the law are almost identical with those of section 214 (a-11) of the federal law. The chief difference is that the words "or associations" have been added after "corporations." By section 1 of the federal law "corporations" include "associations."

The law as originally enacted permitted only the deduction of amounts paid to corporations incorporated by or asso-

ciations organized under the laws of New York, but such restrictions have been removed in the present law as to residents although they still hold as to non-residents.³

Definition of religious, charitable, scientific and educational corporations and associations.—

REGULATION. In order to be deductible, contributions must be to a corporation or association: (a) organized and operated exclusively for one or more of the specified purposes; (b) no part of its income must inure to the benefit of any private stockholder or individual.

Charitable corporations include an association for the relief of the families of clergymen, even though the latter make a contribution to the fund established for this purpose; or for furnishing the services of trained nurses to persons unable to pay for them; or for aiding the general body of litigants by improving the efficient administration of justice. Educational corporations may include an association whose sole purpose is the instruction of the public. This is true of an association to promote acquaintance with the Spanish language and literature, although it has incidental amusement features; of an association to increase knowledge of the civilization of another country; and of a Chautauqua association whose primary purpose is to give lectures on subjects useful to the individual and beneficial to the community and whose amusement features are incidental to this purpose. But associations formed to disseminate controversial or partisan propaganda are not educational within the meaning of the statute. Scientific corporations include an association for the scientific study of law, to the end of improvement in its administration. (Art. 202.)

The above definition excludes private charity. Gifts to impecunious relatives may not be deducted.

“Associations” in connection with charitable contributions.—

RULING. Your letter of January 16th, concerning the construction which should be placed on Section 360, Sub-division 10 of the Tax Law, relative to deduction of charitable contributions, has been carefully considered.

This sub-division provides for the deduction of contributions to corporations or “associations” organized under the laws of this State,

³See Chapter XVIII.

and operated exclusively for religious, charitable, scientific and educational purposes. The term "associations" is not defined in the Income Tax Law, nor, to my knowledge, elsewhere in the Consolidated Laws. It cannot mean to include only joint stock associations as they are organized only for profit. There is no provision in the Consolidated Laws for "organizing" any associations other than joint stock associations. Hence, the requirement that associations be organized under the laws of this State cannot refer to technical, formal organizations, like that of corporations or joint stock organizations, but must mean *practical* organizations, and "under the Laws of this State" cannot mean in pursuance of a statutory provision, there being no such statutory provision, but must rather be taken to indicate that the association is lawfully carrying on its activities—not violating any law of the State—by being organized and carrying on its activities within the State.⁴

The Code of Civil Procedure (1919) makes it possible for an association of seven or more members, having a president or treasurer, to sue or be sued in the name of such officer. I am of the opinion, therefore, that an organization comes within the provision of this section, if it is an association of seven or more members, having a president or treasurer, and is capable of suing and being sued under the Code.

If such organization or association is lawfully within the State of New York, and organized or carrying on any part of its activities within such State, contributions to the extent of fifteen per cent of the taxpayer's net income, without the benefit of this deduction, are deductible, provided, however, the following conditions are met: (a) It must be operated exclusively for religious, charitable, educational or scientific purposes or for the prevention of cruelty to children or animals, and (b) no part of the net earnings must inure to the benefit of any stockholder or individual.

Associations formed to disseminate controversial or partisan propaganda are not educational within the meaning of the statute. (Official ruling, dated March 1, 1920.)

Contributions to Red Cross, Y. M. C. A., etc.—

RULING. The law permits deductions for contributions made to religious, charitable and educational institutions incorporated under the laws of the State of New York, to an amount not exceeding 15% of the taxpayer's net income. A liberal interpretation has been placed upon this section by this office so that contributions made to the Red Cross, Y. M. C. A., Boy Scouts, Girl Scouts and any war service organizations may be deducted to an amount not exceeding

⁴The restriction "under the laws of this state" applies now to non-residents only.

15% of the net income of the taxpayer. (Official ruling, dated January 12, 1920.)

Contributions to military organizations.—

RULING. I have considered the question of whether contributions to organizations of the National Guard, the New York Guard, civil associations connected with those organizations, and organizations such as the American Legion are deductible items under subdivision 10 of Section 360 of the Tax Law. That subdivision permits the deduction to an amount not in excess of fifteen percentum of the taxpayer's net income of contributions or gifts made within the taxable year to corporations incorporated by and associations organized under the laws of this State, and operated *exclusively* for religious, charitable, scientific or educational purposes, or for the prevention of cruelty to children or animals.

While these organizations, probably do, to some extent, result in educational benefit to members, I think it is obvious that they are not operative exclusively for educational purposes, or for any other of the purposes incorporated under subdivision 10. This being the case, contributions to such organizations are not deductible under that subdivision, and there is no other provision in the Income Tax Law under which they could be deductible.

The question of whether such contributions, some of which undoubtedly result to some extent in a general public benefit, should be deductible is a matter not for the Comptroller, the Attorney General, or the Courts to pass upon, but one exclusively within the jurisdiction of the legislature. The legislature has not as yet seen fit to make them deductible, and until it does so, I must advise you not to permit the deduction of any of them in the computation of net incomes under article 16 of the tax law. (Attorney-General's Income Tax Letter No. 29, dated April 14, 1920.)

While it may not be possible to deduct contributions to the National Guard under a literal interpretation of the law, yet it would seem that the liberal interpretation which was given so as to include the Red Cross, etc., could again be invoked so as to permit the deduction of contributions to such organizations as the National Guard, which are of undoubted value to the country, and in no sense are conducted for the personal profit of the members.

Examples of deductible contributions.—The following answer of the Comptroller will indicate his opinion of the

deductibility of contributions to the organizations mentioned therein.

RULING. Are contributions to the following organizations, within amounts limited by the personal income tax law deductible to resident taxpayers:

1. American Association for Labor Legislation.
2. Anti-Saloon League.
3. Apostolic Institute.
4. Boy Scouts.
5. Children of the Frontier.
6. Citizens Union.
7. Delta Chi Law Fraternity.
8. Improvement Association of.....County.
9. Knights of Columbus.
10. League to Enforce Peace.
11. National Birth Control League.
12. Playgrounds' Recreation Association of America.
13. Roosevelt Memorial Association.
14. Zionist Organization.

No, as to items 1, 2, 6, 7, 8, 10, 11, 13 and 14.

Yes, as to items 3, 4, 5 and 12.

Yes, as to item 9, if limited to relief or educational work.
(Question 49, Comptroller's Questions and Answers, 1921.)

For a discussion of items held to be deductible by the Treasury (and probably also permissible under the state law), see *Income Tax Procedure*, 1921, page 698 *et seq.*

The foregoing illustrates the flexibility of the rulings. Gifts to the Zionist Organization are held not to be deductible by the above ruling, yet in a later series of questions and answers published in the press, the following appears:

Q. May I deduct my contributions to the Zionist Organization of America?

A. Yes, because this was a religious organization and no part of whose earnings inured to the private benefit of any individual.

Rule for valuing gifts.—

REGULATION. Where the gift is other than money, the basis for calculation of the amount of the gift shall be the fair market value of the property at the time given, but the difference between such value and cost (or fair market value on January 1, 1919, if acquired before that date) shall be returned as profit or loss by the donor. (Art. 201.)

The first half of the above regulation is identical with the old article 251 of the federal regulations and has not been amended to correspond with the federal ruling now current. The federal regulation⁵ now establishes as a basis for deduction the cost (or fair market value at March 1, 1913, if acquired prior to that date), less that amount of depreciation deducted from gross income in the current and previous years which has not been expended in making good the depreciation sustained. A similar amendment, with January 1, 1919, as the pivotal point, should be made in the state regulation.

LOSS FROM GIFTS.—The second half of article 201 quoted above permits the taxpayer to claim a loss where the market value of the gift at the time given is less than the cost or market value at January 1, 1919, if acquired prior thereto.

The question of a taxable profit to the donor on a gift is treated on page 201.

The distinction between gifts and business expenses.—There are many so-called gifts which are generally charged to some expense account and are treated as ordinary and necessary expenses of doing business. If an answer to the question: "Was the expenditure made to further my business interests?" can be answered in the affirmative, it is an allowable deduction as intended by the law. Thus membership fees in chambers of commerce are deductions allowable to business and professional men.⁶

For a further discussion of this topic, see *Income Tax Procedure*, 1921, page 702 *et seq.*

Insurance

Life insurance premiums paid by insured not deductible.—

REGULATION. . . . Premiums paid for life insurance by the insured are not deductible. . . . (Art. 121.)

⁵Article 251, as amended by Bulletin 15-20-856; T. D. 2998. See *Income Tax Procedure*, 1921, page 700.

⁶See ruling, page 271.

This regulation accords with the corresponding sentence in article 291 of the federal regulations.

The author has raised the question⁷ as to whether the security of a source of taxable income gained by insurance should be taken into consideration in levying a tax. Both state and federal regulations, however, consider life insurance premiums paid by the beneficiary as personal expenses and therefore not deductible.

“Business” life insurance premiums not deductible.—

LAW. Section 361.

4. Premiums paid on any life insurance policy, covering the life of any officer or employee, or of any person financially interested in any trade or business carried on by the taxpayer, when the taxpayer is directly or indirectly a beneficiary under such policy.

REGULATION. Where the taxpayer pays premiums on an insurance policy on the life of an employee or individual financially interested in the taxpayer's business, for the purpose of protecting himself from loss in the event of the death of any such person, such premiums are not deductible from his gross income. But if the taxpayer is in no sense a beneficiary under such a policy, except as he may derive advantage from the increased efficiency of the employee, and pays the premiums purely as reasonable additional compensation of such employee, they are allowable deductions. (Art. 121.)

It will be noted that the regulation draws a distinction between those cases in which the taxpayer is directly a beneficiary—when the deductions are not permitted—and those cases (such as “group” insurance premiums) in which the taxpayer benefits only indirectly.

Accident insurance premiums.—The law⁸ provides that the proceeds of accident insurance policies are non-taxable income. For this reason premiums paid on such policies are not allowable deductions.

Property insurance premiums—when deductible.—

REGULATION. Premiums for insurance against fire, storm, theft,

⁷See *Income Tax Procedure*, 1921, page 708.

⁸Section 359, 1, e.

accident or other similar losses in the case of a business, including employer's liability and workmen's compensation insurance, are deductible business expenses. Insurance paid on a dwelling owned and occupied by the taxpayer, is a personal expense, and not deductible. Premiums paid for life insurance by the insured are not deductible. . . . (Art. 121.)

This regulation indicates the distinction between the types of insurance which are business expenses—and therefore deductible—and those which are personal expenses and non-deductible.

Rentals

Rent paid as a deductible item of expense.—

LAW. Section 360. . . .

1. . . . including rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity. . . .

This section of the law is identical with the corresponding provision in section 214 (a-1) of the federal law.

REGULATION. Rent for the use of business property is a deductible expense. In the case of a professional man who rents a property for residential purposes but incidentally receives there clients, patients or callers in connection with his professional work (his place of business being elsewhere) no part of the rent is deductible as a business expense. If, however, he uses part of the house for his office, such portion of the rent as is properly attributable to such office is deductible. . . . (Art. 120.)

This regulation is identical with article 291 of Regulations 45. It applies only when the taxpayer *rents* the house; but a rental equivalent is not deductible when the taxpayer owns the house.⁹

Taxes paid by a tenant.—

REGULATION. . . . Taxes paid by a tenant to or for a landlord for business property are additional rent and constitute a deductible item to the tenant and taxable income to the landlord, the amount of the tax being deductible by the latter. . . .

⁹See question 41, Comptroller's Questions and Answers, 1921, quoted on page 274.

Cost of lease may be apportioned over term as rent.—

Where a leasehold is acquired for a specified sum, the purchaser may take as a deduction in his return an aliquot part of such sum each year, based on the number of years the lease has to run. . . . (Art. 120.)

The wording of the above regulation is almost paralleled by article 109 of the federal regulations. A bonus paid to secure a lease should be treated as a deferred asset and should be written off over the period of the lease. This in effect will increase the rental which is deductible by the appropriate portion of the bonus paid.¹⁰

Permanent improvements on leased ground.—

REGULATION. . . . The cost of erecting buildings or permanent improvements on ground leased by a taxpayer is additional rental and is, therefore, a proper deduction from gross income, provided such buildings and improvements under the terms of the lease revert to the owner of the ground at the expiration of the lease. In such a case, the cost will be prorated according to the number of years constituting the term of the lease. The lessee will not be permitted to deduct from gross income any depreciation with respect to such buildings, but the cost of incidental repairs necessary to keep them in an efficient condition for the purposes of their use may be deducted. If, however, the life of the improvement is less than the life of the lease, depreciation may be taken by the lessee instead of treating the cost as rent. (Art. 120.)

This regulation is identical with article 109 of the federal regulations as it originally stood. The wording has now been completely altered in the federal text,¹¹ but the effect on the lessee is not changed. The cost of permanent improvements prorated over the unexpired period of the lease can be deducted as an expense, but there is no provision as to the cost of restoring the property at the end of the lease. The Treasury will not permit as deductions amounts set up annually as reserves to provide for the latter and will permit only the deduction of the actual expenditure if and when paid. It is

¹⁰See *Income Tax Procedure*, 1921, page 717.

¹¹*Ibid*, page 715.

presumed that the Comptroller will take similar action on this question.

Business Expenses Distinguished from Capital Outlay

Capital expenditures not deductible.—

LAW. Section 361. In computing net income no deduction shall in any case be allowed in respect of

2. Any amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate;

3. Any amount expended in restoring property or in making good the exhaustion thereof for which an allowance is or has been made;

REGULATION. Amounts paid for increasing the capital value or for restoring the depreciated value of property are not deductible from gross income. . . . (Art. 125.)

Although expenditures on betterments are not deductible, allowances may be made for repairs and for depreciation.

REGULATION. The cost of incidental repairs which neither materially add to the value of the property nor appreciably prolong its life, but keep it in an ordinarily efficient operating condition, may be deducted as expense, provided the plant or property account is not increased by the amount of such expenditures. Repairs in the nature of replacements, to the extent that they arrest deterioration and appreciably prolong the life of the property, should be charged against the depreciation reserve. (Art. 113.)

This regulation is identical with article 103 of the federal regulations. It applies only to property used in business and not to a taxpayer's residence, as will be learned from the following:

RULING. Referring to your last question, no repairs to that part of your residence in which you live are deductible, and you need not include the rental value in your income, nor can you deduct the rental value as an expense. (Official ruling, dated January 8, 1920.)

Cost connected with title to property not deductible.—

REGULATION. . . . The cost of defending or perfecting title to property constitutes a part of the cost of the property and is not a deductible expense. . . . (Art. 125.)

Although the cost of perfecting title is a proper capital charge, the cost of defending such title may not add anything to the value of the property and for this reason should be deducted as a business expense.

Architect's fee not a business expense.—

REGULATION. . . . The amount expended for architect's services is part of the cost of the building. . . .

Cost of copyright and plates not deductible.—

. . . . Amounts expended for securing a copyright and plates, which remain the property of the person making the payments, are investments of capital. . . . (Art. 125.)

It should be noted that although the above two items cannot be deducted when expended, they become allowable deductions as depreciation when spread over a term of years.

Expenses connected with purchase and sale of securities.—

REGULATION. Commissions paid in purchasing securities are a part of the cost price of such securities. Commissions paid in selling securities are an offset against the selling price.

Expenses of administering estates.—

Expenses of the administration of an estate, such as court costs, attorney's fees and executor's commissions, are chargeable against the corpus of the estate and are not allowable deductions. . . .

Expenses incurred by a legatee to sustain or attack the validity of a will are not deductible expenses. . . . (Art. 125.)

It should be noted that additional assessments on national bank stock are generally required only in case of liquidation, and in such a case the taxpayer will recoup his assessment in the deductible loss occurring at settlement.

Assessments on stock.—

REGULATION. . . . Amounts to be assessed and paid under an agreement between bondholders or stockholders of a corporation, to be used in a reorganization of the corporation, are investments of capital and are not deductible for any purpose in returns of income. An

assessment paid by a stockholder of a national bank on account of his statutory liability is similarly not deductible. . . . (Art. 125.)

Trading stamps expenditure a business expense.—

REGULATION. Where a taxpayer for the purpose of promoting his business, issues with sales trading stamps or premium coupons redeemable in merchandise or cash, he should in computing the income from such sales subtract only the amount received or receivable which will be required for the redemption of such part of the total issue of trading stamps or premium coupons issued during the taxable year as will eventually be presented for redemption. This amount will be determined in the light of the experience of the taxpayer in his particular business and of other users engaged in similar businesses. The taxpayer shall file for each of the five preceding years, excluding the taxable year, or such number of these years as stamps or coupons have been issued by him, a statement showing (a) the total issue of stamps during each year, (b) the total stamps redeemed in each year, and (c) the percentage for each year of the stamps redeemed to the stamps issued in such year. A similar statement shall also be presented showing the experience of other users of stamps or coupons whose experience is relied upon by the taxpayer to determine the amount to be subtracted from the proceeds of sales. The Comptroller will examine the basis used in each return, and in any case in which the amount subtracted in respect of such stamps or coupons is found to be excessive an amended return or amended returns will be required.

In the case of an individual furnishing a co-operative or other trading stamp system for others, he shall compute his income in accordance with the same principles and submit similar statements with his return. (Art. 80.)

The above regulation is identical with the federal article 88, with the exception that the second paragraph is an addition in the state regulations.

CHAPTER XIII

DEDUCTIONS FOR INTEREST AND TAXES

This chapter deals with deductions for interest and taxes paid by a resident of the state.

Summary of Differences Between State and Federal Procedure

The state permits a resident to deduct all interest paid or accrued without limitation as to the purpose of the loan or the nature of the collateral. The federal law does not allow as a deduction interest paid to purchase or carry certain tax-exempt securities. (See below.)

In the case of a resident, no income taxes whatever are deductible for state purposes, whereas state income taxes may be deducted in the federal return. (See page 292.)

The amount of income tax paid to another state or country is allowable by the state under certain conditions as a credit against the tax of a non-resident. There is no similar provision under the federal law. (See Chapter XVIII.)

British income tax withheld at the source, which may be credited in the federal return against the total tax, may not be so credited in the state return by a resident. (See page 295.)

Tax-free covenants are held to be void by the state, but are not so held under the federal rulings.

Interest

Interest as a deductible item.—

LAW. Section 360. In computing net income there shall be allowed as deductions: . . .

2. All interest paid or accrued during the taxable year on indebtedness. . . .

REGULATION. A resident is entitled to deduct from gross income all interest paid or accrued during the taxable year. See article 434 for interest deductions allowable to nonresident.¹ (Art. 136.)

¹See Chapter XVIII.

This is the first year in which residents have been permitted to deduct all interest paid. In 1919 only the proportion of total interest which the taxable income of the taxpayer bore to his total income was deductible.

There is no restriction in the law corresponding to the federal disallowance of interest on money borrowed by residents to purchase or carry tax-exempt securities.²

For a discussion of accrued interest, see *Income Tax Procedure*, 1921, page 740 *et seq.*

RULING. Replying to your inquiry of December 31, relative to interest on mortgage, you are advised that *all* interest paid or accrued during the taxable year, is deductible. . . . This would, of course, include interest on the mortgage on your residence and interest on deferred payments of street assessments. (Official ruling, dated January 8, 1920.)

Interest on joint indebtedness.—Frequently two or more obligors appear on bonds and other evidences of indebtedness. Bonds which accompany real estate mortgages are usually signed by husband and wife. If real estate is in the name of the wife and the husband pays the entire interest on the bond, it is a deduction in his return because he is liable for the indebtedness. The liability is not apportionable unless specific provision for apportionment has been made. The interest payments are deductible by those who make them so long as the one who pays is responsible for the indebtedness.

Interest on taxpayer's own capital not deductible.—

REGULATION. Interest calculated as being a charge against income on account of capital invested in the business, but which does not represent a payment on an interest bearing obligation, is not an allowable deduction from gross income; that is to say, the interest which the money might earn if otherwise invested is not a deductible charge against income. (Art. 137.)

This regulation accords with article 122 of the federal regulations and in the opinion of the author³ is eminently proper.

²See *Income Tax Procedure*, 1921, page 732.

³See *Income Tax Procedure*, 1921, page 740.

Taxes

The only important difference between the state and federal laws as to the deductibility of taxes is that the state does not allow as deductions income taxes, and so prohibits a deduction for federal and state income taxes paid, whereas the federal law permits the state income tax to be deducted.

Taxes as deductible items.—

LAW. Section 360. In computing net income there shall be allowed as deductions:

3. Taxes other than income taxes paid or accrued within the taxable year imposed, first, by the authority of the United States, or of any of its possessions, or, second, by the authority of any state, or territory, or any county, school district, municipality, or other taxing subdivision of any state or territory, not including those assessed against local benefits of a kind tending to increase the value of the property assessed, or, third, by the authority of any foreign government.

This section of the law is a modification of section 214 (a-3) of the federal law. It excludes all income taxes, whereas the federal statute classifies only income, war profits and excess profits taxes imposed by the authority of the United States or of any of its possessions as non-deductible.

Article 141 of the regulations, quoted below, merely paraphrases the above section of the law.

REGULATION. Taxes other than income taxes paid or accrued within the taxable year imposed, first, by the authority of the United States, or of any of its possessions, or, second, by the authority of any State or Territory, or any county, school district, municipality or other taxing subdivision of any State or Territory, not including those assessed against local benefits of a kind tending to increase the value of the property assessed, or, third, by the authority of any foreign government, are deductible from gross income. (Art. 141.)

The word "paid" is not to be interpreted to include taxes which became due and payable prior to January 1, 1919, but actually were not paid until the taxable year.⁴

⁴Attorney-General's Income Tax Letter No. 42, dated February 4, 1921.

RULING. I am in receipt of a letter from the Seaboard National Bank, which, in accordance with my practice, I am referring to you for answer. My views upon the question raised are these:

Section 360, subdivision 3, permits the deduction from gross income of "Taxes *other than income taxes* . . ." and the question is raised whether the "surtaxes" imposed by the Federal income tax law are "income taxes" within the meaning of the exception. The same question is likely to arise with respect to "excess profits", "war profits" and "undistributed net income" taxes imposed by the United States.

What the United States actually does is to levy income taxes upon all net incomes (subject to specified credits and deductions) and to levy further "surtaxes" upon specified parts of all incomes in excess of specified amounts. It also levies "war profits taxes" on specified incomes from special sources, "excess profits taxes" on specified parts of certain incomes, and "undistributed net income taxes" upon certain parts of corporate net incomes. In every case the tax is a tax imposed upon and measured by stated items of income. I regard all these taxes as being based upon the jurisdiction conferred upon the Federal Government by the Sixteenth Amendment to the United States Constitution "to lay and collect taxes on incomes, from whatever source derived, without apportionment, etc."

The Treasury Department in a recent "Law Opinion" (O. 974; 1-20-662) discussing the question of whether "undistributed net income taxes" were "income taxes" within the meaning of those words as used in part of Section 252 of the Federal Revenue Act of 1918 (Act of Feb. 24, 1919) said:

"Section 10 (a) of the Act of September 8, 1916, as amended imposes a tax upon the total net income of corporations. This net income is obtained by excluding or deducting from the total gross income certain items. Section 10 (b) of the Act, as amended, imposes an 'additional tax.' The inference is that this tax is also an income tax. It is imposed by the same section of the law as imposes the tax upon the total net income of corporations and is imposed under Title I of the 1916 Act, as amended, which bears the caption 'Income Tax.' It is imposed not upon the total net income but upon such net income reduced by such amount as is distributed or 'is actually invested and employed in the business or is retained for employment in the reasonable requirements of the business or is invested in obligations of the United States issued after September first, nineteen hundred and seventeen.' Since the undistributed net income tax is imposed on a part of the net income of the taxable year, it is an income tax within the meaning of Section 252 of the Revenue Act of 1918."

The reasoning quoted applies equally to "surtaxes," "war profits taxes," "excess profits taxes," and "undistributed net income taxes."

It is my opinion, therefore, that all these taxes should be regarded as "income taxes" under subdivision 3 of section 360 of the New York Tax Law, and should not be deductible in computing net income. (Attorney-General's Income Tax Letter No. 25, dated March 5, 1920.)

Taxes paid under secured debts laws deductible.—

REGULATION. . . . Amounts paid to States under secured debts laws in order to render securities tax exempt are deductible. . . . (Art. 141.)

This regulation is identical with federal article 131.

Automobile license fees deductible.—

REGULATION. . . . Automobile license fees are ordinarily taxes. (Art. 141.)

It should be remembered, however, that the tax paid on the purchase price of a new car is a manufacturer's tax and as such is *not* deductible by the taxpayer purchasing the car.

Business, excise, license and other taxes deductible.—

REGULATION. Import or tariff duties paid to the proper customs officers, and business, license, privilege, excise and stamp taxes paid to internal revenue collectors, are deductible as taxes imposed by the authority of the United States, provided they are not added to and made a part of the expenses of the business or the cost of articles of merchandise with respect to which they are paid, in which case they cannot be separately deducted. (Art. 142.)

This regulation is identical with article 132 of the federal regulations. It must not be construed as limiting the deduction, but it indicates that a dealer cannot deduct the taxes twice. The provision as to payment to internal revenue collectors must not be interpreted to mean that only taxes so paid are deductible. It means that such taxes are among the allowable deductions.

Under this regulation customs duties and the so-called "luxury" taxes are deductible. Taxpayers should keep a record of such taxes so that they may be prepared to substantiate the deductions on their returns. For information

as to luxury taxes, see *Income Tax Procedure*, 1921, pages 764 *et seq.*

Foreign taxes, other than income taxes deductible.—It should be noted that all foreign taxes with the exception of income taxes are deductible under article 141. As a result of the exclusion of income taxes, the British tax on dividends is not an allowable deduction.⁵ The *gross* income from which the tax has been withheld under the British income tax law must be reported, i.e., the tax deducted at source must be added back to the net amount received.

The federal law permits foreign income and profits taxes to be offset against the amount of tax due to the United States. When the taxpayer is subject to a high surtax this concession is of considerable value to him.

“Foreign country” defined.—

LAW. Section 350. . . .

9. The words “foreign country” or “foreign government” mean any jurisdiction other than one embraced within the United States. The words “United States” include the states, the territories of Alaska and Hawaii and the District of Columbia.

The words “foreign country,” defined above, do not appear elsewhere in the income tax law. The above definition of the words “United States” is applicable only to the words as they are used in the immediately preceding sentence defining “foreign government.”

Federal income tax cannot be deducted.—As the federal income tax comes within the category of an income tax, it cannot be deducted.⁶

Special assessments may or may not be deductible.—The author has discussed the question of special assessments fully

⁵See page 252 as to British dividends on which tax has been withheld.

⁶See page 292.

in *Income Tax Procedure*, 1921.⁷ Assessments tending to increase the value of the property against which they are assessed are capital expenditures and therefore not deductible; but if they do not increase the value of the property they are deductible. In the author's opinion, the state limitation on assessments for maintenance or repair of local benefits to such as are necessary to the conduct of the taxpayer's business is illegal and should be eliminated.⁸

REGULATION. So called taxes, more properly assessments, paid for local benefits, such as street, sidewalk and other like improvements, imposed because of and measured by some benefit inuring directly to the property against which the assessment is levied, do not constitute an allowable deduction from gross income. A tax is considered assessed against local benefits when the property subject to the tax is limited to the property benefited. Special assessments are not deductible, even though an incidental benefit may inure to the public welfare. The taxes deductible are those levied for the general public welfare by the proper taxing authorities at a like rate against all property in the territory over which such authorities have jurisdiction. Assessments under the statutes of California relating to irrigation and of Iowa relating to drainage, and under certain statutes of Tennessee relating to levees, are limited to property benefited, and when it is clear that the assessments are so limited, the amounts paid thereunder are not deductible as taxes. When assessments are made for the purpose of maintenance or repair of local benefits, the taxpayer may deduct the assessments paid as an expense incurred in business, if the payment of such assessments is necessary to the conduct of his business. When the assessments are made for the purpose of constructing local benefits, the payments by the taxpayer are in the nature of capital expenditures and are not deductible. Where assessments are made for the purpose of both construction and maintenance or repairs, the burden is on the taxpayer to show the allocation of the amounts assessed to the different purposes. If the allocation cannot be made none of the amounts so paid is deductible. (Art. 143.)

When such improvements have been properly capitalized and added to the cost of the property benefited, the depreciation charges on the improved property may be increased if the benefit is of a more or less depreciable nature.

⁷See page 771 *et seq.*

⁸See *Income Tax Procedure*, 1921, page 772.

BRONX VALLEY SEWER ASSESSMENTS DEDUCTIBLE.—

RULING. I acknowledge receipt of your inquiry of January 12, 1919, with respect to the deductibility under section 360, paragraph 3 of the Income Tax Law of assessments levied under the Bronx Valley Sewer Act (L. 1905 c. 646 as amended).

I have had occasion to examine, at the instance of the Armory Commission, the question of whether these assessments should be regarded as taxes or as assessments for local improvements, for the purpose of determining whether or not the State was liable for them, when assessed against armories. My conclusions are set forth in an opinion dated October 7, 1919, addressed to the Armory Commission, to which you are referred.

My opinion was to the effect that these assessments, by reason of the phraseology of the statute authorizing them and the long term over which they are distributed, must be regarded as taxes (from which the State is exempted by Tax Law Sec. 4, Paragraph 2) rather than as assessments for local improvements (to which the State is subjected by Public Lands Law, Sec. 21). I believe that the same conclusion must be reached in considering them in connection with the Income Tax Law (Sec. 360, Paragraph 3) and that they should be regarded as proper deductions from gross income. (Attorney-General's Income Tax Letter No. 15, dated January 17, 1920.)

The deductibility of assessments such as the above depends on the literal interpretation of the statute authorizing them. This will be apparent from the following:

RULING. I have examined the Rochester City Charter (L. 1907 c. 755) where, in section 118, provision is made for assessments for the East Side Sewer.

The language of this provision satisfies me that these assessments should be regarded as being "assessed against local benefits of a kind tending to increase the value of the property assessed" within the second exception under subdivision 3 of section 360 of the tax law.

The phraseology of the Rochester Act is entirely different from that of the Bronx Valley Sewer Act referred to in my Income Tax Letter, No. 15 and the reasoning adopted in that letter cannot apply to its interpretation. (Attorney-General's Income Tax Letter No. 22, dated February 17, 1920.)

Charges for water.—

RULING. So-called "water taxes," more properly speaking "water rates" or "charges," are seldom deductible. When payment is made for water consumed and the charge is based upon meter readings or

computed on a flat rate schedule, according to the number of faucets, bath tubs, toilets, etc., installed, or in any other manner where consumption, actual or theoretical, is the basis of the charge, the amount is not deductible whether called a water rate or tax. If you refer to a frontage tax assessed at a uniform rate upon the basis of flat foot frontage, the payment so made is a tax and deductible as such. (Official ruling, dated January 23, 1920.)

The first part of the above ruling is obviously correct and equitable as there is no reason why the charge for water should be considered as different from that for electric light.

The author cannot agree with the last sentence nor with the following ruling, as it is obvious that, however assessed, the intention is to pay for a service received.

RULING. If a village assesses water rents according to the frontage of the property, is the amount deductible?

Yes. Water rents and other assessments of this character where they are not improvements to the property are deductible, if they are not based upon the amount of consumption of water. They are in the nature of taxes rather than rent. However, if based upon meter readings or computed on a flat schedule where consumption is the basis of the charge, this amount would not be deductible. (Question 60, Comptroller's Questions and Answers, 1921.)

Inheritance and estate taxes not deductible.—

REGULATION. State inheritance taxes paid by the executor or administrator of an estate of a deceased person, which are provided by law to be deducted from the respective legacies or distributive shares, are not allowable deductions in computing the net income of such estate subject to tax, even though the will contains a direction to pay inheritance taxes out of the residue. An inheritance tax is upon the transfer of the property and not upon the estate of the decedent or upon the executor or administrator, although the latter is required to pay it. In general, taxes paid or accrued within the year imposed by the authority of any State, or otherwise, are limited to those imposed upon the taxpayer and do not include taxes paid by him on behalf of another, even though he is required by law to make such payment. Since, moreover, the tax is imposed upon the transfer before the property reaches the legatee or distributee, and merely diminishes the capital share of the estate received by him, such tax is not imposed upon the legatee or distributee and is not an allowable deduction from his income. Similarly, Federal estate taxes are not deductible. (Art. 144.)

Postage not deductible as a tax.—

REGULATION. . . . Postage is not a tax. . . . (Art. 141.)

But postage incurred in connection with a business is a deductible expense.

Tax-free covenant bonds.—The author is of the opinion that the action of the state legislature in attempting to prohibit covenants to pay the state tax for bondholders⁹ is unconstitutional in that it limits the individual's right to contract. As long as the statute remains in its present form the recipient of interest on securities containing a contract calling for payment of the state income tax by the obligor cannot deduct such tax in his return.

On each \$100 of tax-free covenant interest the obligor will pay \$2 tax, which is a credit against the individual's federal taxes. The state of New York does not require withholding at the source; therefore no credit can be taken in the New York return. The federal government requires that the \$2 be reported as additional income, and the state of New York for some unknown reason makes the same requirement. For discussion of this subject, see *Income Tax Procedure*, 1921, page 516 *et seq.*

⁹Section 385, page 143.

CHAPTER XIV

DEDUCTIONS FOR LOSSES AND BAD DEBTS

The allowable deductions for losses and bad debts are the same under the state and federal laws. The disinclination of the federal Treasury to allow reserves for bad debts is shared by the Comptroller.

Generally speaking, residents may deduct all losses actually sustained when arising from transactions undertaken for profit and all losses without such restriction when arising from casualties.

Summary of Differences Between State and Federal Procedure

The basis for computing the loss is the fair market value of the property at January 1, 1919 (if acquired prior thereto). The corresponding date in the federal law is March 1, 1913. (See page 301.)

Losses sustained by non-residents are limited to those relating to real property and tangible personal property having an actual situs within the state. No corresponding limitation is found in the federal law, as regards non-residents of New York State. (See Chapter XVIII.)

In claiming a deduction for bad debts special data are required in the state return which are not required in the federal return. (See page 310.)

Deductions for Losses

Losses as deductible items.—

LAW. Section 360. In computing net income there shall be allowed as deductions:

4. **Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in trade or business.**

5. **Losses sustained during the taxable year and not compen-**

sated for by insurance or otherwise, if incurred in any transaction entered into for profit, though not connected with the trade or business; but in the case of a taxpayer other than a resident of the state, only as to such transactions in real property or intangible personal property having an actual situs within the state.

6. **Losses sustained** during the taxable year of property not connected with the trade or business (but, in the case of a taxpayer other than a resident, only of real property or tangible personal property having an actual situs within the state) if arising from fires, storms, shipwrecks, or other casualty or from theft, and not compensated for by insurance or otherwise. . . .

The above section of the law closely parallels section 214 (a-4, 5 and 6) of the federal statute, the provisions in the latter as to non-resident aliens being made applicable in the state law to non-residents.

REGULATION. Losses sustained during the taxable year and not compensated for by insurance or otherwise are fully deductible (except by non-residents) if (a) incurred in the taxpayer's trade or business, or (b) incurred in any transaction entered into for profit, or (c) losses of property arising from fires, storms, shipwreck or other casualty, or from theft. . . . (Art. 151.)

This regulation is very similar to article 141 of Regulations 45.

Measurement of property losses.—

REGULATION. . . . In the case of the sale of assets the loss will be the difference between the cost thereof, less depreciation sustained since acquisition, or the fair market value as of January 1, 1919, if acquired before that date, less depreciation since sustained, and the price at which they were disposed of. . . . They must usually be evidenced by closed and completed transactions. . . . (Art. 151.)

The basis of calculating losses is cost or fair market value at January 1, 1919, if acquired prior to that date. Because of this valuation as of January 1, 1919, it is possible that a loss may be incurred although the asset be sold for more than original cost. For example, property bought at \$100,000 in 1900 might have been valued at \$150,000 on January 1, 1919. If sold in 1920 for \$130,000, a loss of \$20,000 (\$150,000-

\$130,000) could be deducted, although there was a real profit of \$30,000.

In order to take advantage of this provision, taxpayers should record January 1, 1919, values on their books, preferably as memoranda.

It should be noted that losses can be claimed only through bona fide sales and must be evidenced by closed and completed transactions. A mere fall in the market price is not warrant for claiming a loss.

Losses by fire, etc.—A method similar to the above is prescribed for the calculation of losses due to the destruction of property by fire, flood or other casualty.

REGULATION. . . . When the loss is claimed through the destruction of property by fire, flood or other casualty, the amount deductible will be the difference between the cost of the property or its fair market value as of January 1, 1919, if acquired prior thereto, and the salvage value thereof, after deducting from the cost (or value as of January 1, 1919), the amount, if any, which has been or should have been set aside and deducted in the current year and previous years from gross income on account of depreciation and which has not been paid out in making good the depreciation sustained. But the loss should be reduced by the amount of any insurance or other compensation received. . . . (Art. 151.)

Losses on sales of securities.—As will be seen from the above regulation loss on the actual sale of securities is a deduction permitted by the law, but there must be a closed transaction through an actual sale. Fluctuations in the market are disregarded unless the taxpayer is a dealer in securities. In that case he will be permitted to take advantage of such losses through the inventorying of securities on hand.

Losses due to scrapping of buildings and machinery.—

REGULATION. Loss due to the voluntary removal or demolition of old buildings, the scrapping of old machinery, equipment, etc., incident to renewals and replacements will be deductible from gross income in a sum representing the difference between the cost of such property demolished or scrapped (or its fair market value on

January 1, 1919, if acquired prior thereto) and the amount of a reasonable allowance for the depreciation which the property had undergone prior to its demolition or scrapping; that is to say, the deductible loss is only so much of the original cost (or value as of January 1, 1919) of the property, less salvage, as would have remained unextinguished had a reasonable allowance been charged off for depreciation during each year prior to its destruction. . . . (Art. 152.)

The above regulation, which is identical with article 142 of the federal regulations, must not be interpreted to mean that the measure of the loss is the excess of cost over salvage value, plus an allowance for depreciation which was "reasonable," although not that charged off by the taxpayer in past years. True it is that the taxpayer could amend past returns and use the "reasonable" rate. But in order to save this inconvenience it is permissible to take the whole loss (between cost and the actual depreciation taken plus salvage) at the time of scrapping, unless such a procedure would materially affect the income returned in previous years, when amended returns would be demanded by the Comptroller.

Cost of demolishing old building on new site not deductible as loss.—

REGULATION. . . . When a taxpayer buys real estate upon which is located a building which he proceeds to raze with a view to erecting thereon another building, it will be considered that the taxpayer has sustained no deductible loss by reason of the demolition of the old building, and no deductible expense on account of the cost of such removal, the value of the real estate, exclusive of old improvements, being presumably equal to the purchase price of the land and building plus the cost of removing the useless building. (Art. 152.)

This regulation, identical with federal article 142, disallows the cost of demolition on the theory that it is a capital expenditure and therefore not deductible.

Business losses.—In discussing business losses in *Income Tax Procedure*, 1921, the author classified the factors determining deductibility as follows:

1. The loss must be an actual one—the taxpayer must be “out of pocket.”
2. The loss must have been sustained during the taxable year.
3. The transaction in which the loss occurred must have been undertaken for profit.
4. It must be a net loss, any insurance, etc., being credited against the gross loss sustained.

Loss on sale of individual's residence.—

REGULATION. . . . A loss in the sale of an individual's residence is not deductible. . . . (Art. 151.)

This regulation, identical with federal article 141, disallows this type of loss because it does not comply with the third factor mentioned above—the transaction was not undertaken for profit. If evidence can be adduced that the property was purchased for investment and with a view to profit and that residence therein was incidental to the main purpose, the loss on sale can be deducted.

Even though a property originally was not purchased for investment, there is much to be said in favor of deducting any loss which occurs *subsequently* to the time when in fact the property became income-producing. If a residence was purchased in 1915 and was occupied by the owner until 1917 when it was rented to a tenant for ten years, surely on January 1, 1919, the property was just as much an investment as stocks or bonds. If sold in 1920 for less than the January 1, 1919, value, the loss was an allowable deduction.

The situation should be the same when the change from a residence to an investment took place after 1919. It might be said that the act of renting a residence was a conversion to an investment or business use and was the equivalent of a transaction entered into for profit. Any loss actually sustained thereafter should be allowed. The basis of the deduction would be the value of the property at the date it became an

income-producing property, i.e., a transaction entered into for profit.

Losses of the nature of personal expenses not deductible.—
Examples of such losses are given in the following answers:

RULINGS. If a man operates for his own convenience a fish hatchery may he deduct the loss on account of such operations?

No. This is analogous to the case of a taxpayer maintaining a farm or a ranch for other than business purposes, and any amount or loss on account of such operations is not deductible. (Question 70, Comptroller's Questions and Answers, 1921.)

Would the cost of settling a negligence action brought by the owner of a wagon which was damaged by an automobile of the taxpayer used for pleasure purposes be deductible to the car owner?

No. This is a personal expense. (Question 53, Comptroller's Questions and Answers, 1921.)

Losses in illegal transactions may not be deducted.—

REGULATION. . . . Losses in illegal transactions are not deductible. (Art. 151.)

Although gains from illegal transactions, in both state and federal regulations, are to be returned as taxable income, losses in such transactions are not allowed as deductions.¹ The law,² however, does not restrict the transactions on which losses can be claimed and for that reason this regulation may not be valid. It is doubtful, however, whether anyone would contest its validity in view of the penalties which might result from a confession of illegal acts committed.

When, however, a transaction is illegal in New York but legal in foreign countries, such as Cuba or Monaco, losses arising from gambling are deductible, because the taxpayer entered into the transactions for profit. Taxpayers who desire to deduct losses sustained at Monte Carlo or Havana should be prepared to substantiate their claims, and, incidentally, be

¹See Question 50, Comptroller's Questions and Answers, 1921; see also page 156.

²Section 360, 5; see page 300.

prepared to show that all profits, past and present, from such transactions have been reported.

Losses by theft.—Even if personal property be stolen, the loss is deductible.

RULING. If a private automobile purchased in 1919 was stolen, what amount may the owner deduct as a loss?

. He may deduct the purchase price plus any amounts expended for new parts, less depreciation. (Question 44, Comptroller's Questions and Answers, 1921.)

Deductions for Bad Debts

The provisions of the state law regarding the deductibility of the losses arising from bad debts follow closely those of the federal law, with the exception that January 1, 1919, is to be used as a basis of valuation in the case of debts incurred prior to that date. The chief problems of procedure which arise have to do, first, with a test by which the worthlessness of debts shall be judged and, second, with the manner in which the deduction shall be allowed.

LAW. Section 360. In computing net income there shall be allowed as deductions:

7. Debts ascertained to be worthless and charged off within the taxable year.

Only bona fide debts deductible.—If the original transaction partook more of the nature of a gift than of a loan, the non-repayment cannot be considered as a loss due to a bad debt. In some cases this will be true of advances to needy relatives, when at the date of the advance there was little expectation of repayment.

Income corresponding to bad debts must have been reported in tax returns.—

REGULATION. Worthless debts arising from unpaid wages, salaries, rents and similar items of taxable income will not be allowed as a deduction unless the income such items represent has been in-

cluded in the return of income for the year in which the deduction as a bad debt is sought to be made or in a previous year. . . . (Art. 162.)

This regulation, identical with federal article 152, applies particularly to taxpayers who have rendered returns based on cash receipts and payments.

It must be understood, however, that it does not debar a taxpayer from claiming a deduction in case the account arose before January 1, 1919, although, of course, such items would not have been returned as income. The amount deductible is not necessarily the face value of the debt, but its value at January 1, 1919.

Of course taxpayers carrying a reserve for bad debts on their books will charge the loss against such reserve, but note must be made to deduct the item in the tax return.

Valuation of special types of bad debts.—

BANKRUPTCY CLAIM—EXTENT TO WHICH DEDUCTIBLE.—

REGULATION. . . . Only the difference between the amount received in distribution of the assets of a bankrupt and the amount of the claim may be deducted as a bad debt.

CLAIMS AGAINST DECEDENT'S ESTATE—EXTENT TO WHICH DEDUCTIBLE.—

The difference between the amount received by a creditor of a decedent in distribution of the assets of the decedent's estate and the amount of his claim may be considered a worthless debt.

ACCOUNTS RECEIVABLE PURCHASED—BASIS FOR DEDUCTION.—

A purchaser of accounts receivable which cannot be collected and are consequently charged off the books as bad debts is entitled to deduct them, the amount of deduction to be based upon the price he paid for them and not upon their face value. (Art. 162.)

NOTES RECEIVABLE—BASIS FOR DEDUCTION.—

REGULATION. . . . If a taxpayer computes his income upon the basis of valuing his notes or accounts receivable at their fair

market value when received, which may be less than their face value, the amount deductible for bad debts in any such case is limited to such original valuation. (Art. 161.)

This regulation is identical with federal article 151. Entering notes at less than their face value is equivalent to creating a reserve for bad debts.

WORTHLESS BONDS—EXTENT TO WHICH DEDUCTIBLE.—As a bond is a promise to pay money, any failure to pay constitutes a bad debt.

REGULATION. Where bonds purchased before January 1, 1919, depreciated in value between the date of purchase and that date, and were in a later year ascertained to be worthless and charged off, the owner is entitled to a deduction in that year equal to the value of the bonds on January 1, 1919. Bonds purchased since December 31, 1918, when ascertained to be worthless, may be treated as bad debts to the amount actually paid for them, but not exceeding their amortized value if purchased at a premium. Bonds of an insolvent corporation secured only by a mortgage from which on foreclosure nothing is realized for the bondholders are regarded as ascertained to be worthless not later than the year of the foreclosure sale, and no deduction for such bad debts is allowable in computing the bondholder's income for a subsequent year. . . . (Art. 164.)

With the exception of the substitution of January 1, 1919, as a basis instead of March 1, 1913, this article is identical with federal article 154.

The restriction on the amount of loss to be deducted when premiums have been amortized is equitable. The taxpayer will have deducted from income the amortization instalments, and if he were to exclude these items from computation the deduction for the loss would be excessive.

Likewise if bonds purchased at a discount have been written up and are sold at less than book value the measure of the deductible loss is the difference between the book value and the price received and not the difference between cost and the amount received, because the amortization instalments will have been reported as income.

However, the mere shrinkage in value of securities due to market conditions cannot be allowed as a deduction, except when actually realized by sale.

REGULATION. A person possessing securities, such as stocks and bonds, cannot deduct from gross income any amount claimed as a loss on account of the shrinkage in value of such securities through fluctuation of the market or otherwise. The loss allowable in such cases is that actually suffered when the securities mature or are disposed of. In the case of individual bankers or private bankers who are subject to supervision by State authorities, and who in obedience to the orders of such supervisory officers charge off as losses, amounts representing an alleged shrinkage in the value of property, the amounts so charged off do not constitute allowable deductions. The foregoing applies only to owners and investors, and not to dealers in securities. However, if stock of a corporation becomes worthless, its cost or its fair market value as of January 1, 1919, if acquired prior thereto, may be deducted by the owner in the taxable year in which the stock was ascertained to be worthless and charged off, provided a satisfactory showing of its worthlessness be made as in the case of bad debts. (Art. 154.)

DEBTS HELD PRIOR TO JANUARY 1, 1919—BASIS FOR DEDUCTION.—

REGULATION. . . . To authorize a deduction for a bad debt on account of notes held prior to January 1, 1919, their value on that date must be established. (Art. 164.)

By "established" is meant showing the real or estimated collectible value at January 1, 1919. If the taxpayer considered that the debt was valueless on that date, from the viewpoint of the state tax administration he suffers no loss if and when the debt is established as worthless. On the other hand, if he had reasonable ground for considering the debt to be collectible at its face value at January 1, 1919, he can deduct the whole debt in the year in which it is ascertained to be of no value.

The following answers are of interest:

RULINGS. Is it permissible to deduct as a bad debt an amount represented by a bank account in Petrograd?

No. The State Income Tax Law recognizes value as of January 1, 1919. The Internal Revenue Bureau has recently ruled

that an account in a Russian bank was deductible as a loss for the year 1918. Unless this account has an actual value as of January 1, 1919, the loss in question was sustained prior to the incidence of the State income tax, was without value on January 1, 1919, and is, therefore, not deductible in the State return. (Question 31, Comptroller's Questions and Answers, 1921.)

Is it proper to deduct an amount by reason of a claim existing against the German Government because of conditions in that country?

No. Debts due one belligerent state by citizens of another state, are not extinguishable by war and it, therefore, follows as a corollary that debts due by a belligerent state to a citizen of another state, cannot be considered as valueless. (Question 65, Comptroller's Questions and Answers, 1921.)

Debts must be ascertained to be worthless.—

REGULATION. An account merely written down or a debt recognized as worthless prior to the beginning of the taxable year is not deductible. Where all the surrounding and attendant circumstances indicate that a debt is worthless and uncollectible and that legal action to enforce payment would in all probability not result in the satisfaction of execution on a judgment, a showing of these facts will be sufficient evidence of the worthlessness of the debt for the purpose of deduction. . . . (Art. 161.)

This article is identical with federal article 151.

RULING. If a partnership on an account created in 1919 writes off in 1920 the full amount as a bad debt, is such deduction permitted when the partnership states that it is in hopes of recovering a part of the amount in the near future?

No. Until all legal remedies have been exhausted and it is definitely known that this amount is not recoverable, it cannot be considered a bad debt. Even then, only the fair market value of claim on January 1, 1919, may be deducted. (Question 39, Comptroller's Questions and Answers, 1921.)

In claiming a deduction for bad debts the Comptroller has indicated certain data which must be submitted with the return.

RULINGS. May a taxpayer secure a deduction for bad debts by merely stating their aggregate amount?

No. The Bureau requires the submission of the following facts as to each item: (a) Name and address of the debtor; (b) the year when the amount was created; (c) the full amount of

the debt; (d) the amount written off; (e) why or how the taxpayer determined it to be bad or worthless. (Question 66, Comptroller's Questions and Answers, 1921.)

What additional information is required in the case of a deduction sought on account of a bad debt because of the death of the debtor?

The following facts are required:.

1. Date of decedent's death.
2. Amount of assets and liabilities of the estate.
3. Have letters been issued by any Surrogate's Court, and if so, when and where?
4. Has the estate been judicially settled? (Question 67, Comptroller's Questions and Answers, 1921.)

BANKRUPTCY AS A TEST.—

REGULATION. . . . Bankruptcy may or may not be an indication of the worthlessness of a debt, and actual determination of worthlessness in such a case is sometimes possible before and at other times only when a settlement in bankruptcy shall have been had. Where a taxpayer ascertained a debt to be worthless and charged it off in one year, the mere fact that bankruptcy proceedings instituted against the debtor are terminated in a later year confirming the conclusion that the debt is worthless will not authorize shifting the deduction to such later year. In the case of debts existing prior to January 1, 1919, only their value on that date may be deducted upon subsequently ascertaining them to be worthless. . . . (Art. 161.)

This article is identical with federal article 151. The author hopes that the Comptroller will follow the procedure outlined by the regulation and not incur the charge of "shifting," which can rightly be laid at the door of the Treasury for its interpretation of the regulation.

Foreclosure sale on a mortgage.—

REGULATION. Where under foreclosure a mortgagee buys in the mortgaged property and credits the indebtedness with the purchase price, the difference between the purchase price and the indebtedness will not be allowable as a deduction for a bad debt, for the property which was security for the debt stands in the place of the debt. The determination of loss in such a situation is deferred until the property is disposed of, except where a purchase money mortgage is foreclosed by the vendor of the property. Only where a purchaser for less than the debt is another than the mortgagee may the difference

between the debt and the net proceeds from the sale be deducted as a bad debt. (Art. 163.)

When the owner of a real estate mortgage is unable to collect principal and interest and decides that it is necessary to foreclose in order to protect his investment, and at foreclosure sale buys in the property as the highest bidder, it is difficult to understand why it is not a closed transaction. Usually property depreciates in value before foreclosure takes place. If the owner could not claim credit for the loss arising from the foreclosure sale, it is probable that years would elapse before the actual loss could be shown in any other way.

The law³ provides that "when property is exchanged for other property the property received in exchange shall for the purpose of determining gain or loss be treated as the equivalent of cash to the amount of its fair market value, if any." Therefore when a mortgagee receives, in place of the mortgage, real property, the latter should be valued and the gain or loss, if any, returned.

Compositions and compromises.—When considering the question of compromises and similar settlements, the reader may be interested in the quotation from the bulletin of the National Association of Credit Men, which appears on page 830 of *Income Tax Procedure*, 1921.

Recoveries.—In some cases debts presumably "definitely ascertained to be worthless" have unexpectedly proved to be collectible in whole or in part. The following regulation provides for the taxation of such collections.

REGULATION. . . . Bad debts or accounts charged off because of the fact that they were determined to be worthless, which are subsequently recovered, whether or not by suit, constitute income for the year in which recovered, regardless of the date when the amounts were charged off. . . . (Art. 44.)

³Section 354, page 186.

An exception to this rule would arise if a collection were made of a debt charged off prior to January 1, 1919, which as of that date could be considered good. In such a case it would not be taxable as income when subsequently collected.

Loss of endorser or guarantor—when determined.—Upon the failure of the maker of a note to take it up at maturity, the endorser may have to pay, and thereupon a debt due to the endorser arises. Strictly speaking, it may not be “ascertained to be worthless” immediately, but everyone knows that ordinarily the chances are at least 99 to 1 that it will be a bad debt and usually it takes very little time to reach this conclusion. After allowing a reasonable time in which to ascertain why the maker does not make good, the endorser should charge it off as a bad debt, taking credit for it in his return.

The right to deduct the bad debt is governed by the regulations cited. There is no requirement that the obligation to pay a note as endorser or guarantor shall have arisen from business or trade, so the restrictions of past years as to losses would not apply in any case.

Charging off bad debts.—The law⁴ refers to “bad debts . . . charged off within the taxable year.” This phraseology would seem to indicate that actual book entries must be made in order that the deduction may be claimed. Such a requirement cannot be considered essential in the case of a taxpayer who does not keep formal books, but it is reasonable if books are kept.

“Within the taxable year” refers to the year for which the return is made. It should be construed in an accounting sense—that is, if books of account are closed December 31 and an entry written in the books during January is dated December 31, the entry is deemed to have been made within the year ended December 31.

⁴Section 360, 7; see page 306.

Reserves for bad debts.—There has been no specific ruling or regulation regarding the deductibility of the amount set up during the taxable year as a reserve for bad debts. As in the federal regulation, the state law fixes “ascertained to be worthless” as the criterion, and it is possible that, following federal practice, reserve additions will be disallowed.

The author has expressed his view that the returns (under the federal law) will not reflect good accounting practice until the deduction of bad debt reserves is permitted, and the reader is referred to *Income Tax Procedure*, 1921, page 833, for further discussion.

CHAPTER XV

DEDUCTIONS FOR DEPRECIATION, DEPLETION AND OBSOLESCENCE

Fortunately for taxpayers, the requirements of the state law relative to depreciation, depletion and obsolescence are based on the 1918 federal law and are therefore simple and in the main equitable. The provisions of preceding federal laws were complicated and inequitable. The underlying principle is that the capital of the taxpayer invested in depreciable property must be returned to him free from tax before any income shall be deemed to have accrued. If property was acquired before January 1, 1919, the fair market value at that date is the basis for depreciation and depletion charges. If acquired since January 1, 1919, the basis is cost.

Summary of Differences Between State and Federal Procedure

Depreciation and depletion for state purposes are computed on the fair market value of the property at January 1, 1919, if acquired prior thereto. The corresponding date in the federal law is March 1, 1913.

The time of acquisition of the property is important, e.g.:

1. If acquired after December 31, 1918, for both federal and state purposes the computation must be based on cost.
2. If acquired before January 1, 1919, but after February 28, 1913, for federal tax the computation must be based on cost; for state tax the computation must be based on value at January 1, 1919.
3. If acquired before March 1, 1913, for federal tax the computation must be based on value at March 1, 1913; for state tax the computation must be based on value at January 1, 1919.

Depreciation

LAW. Section 360. In computing net income there shall be allowed as deductions:

8. **A reasonable allowance for the exhaustion, wear and tear** of property used in the trade or business, including a reasonable allowance for obsolescence.

This section of the law is identical with federal section 214 (a-8). It is unnecessary to discuss the propriety of allowing for depreciation, because the necessity for the deduction is now admitted by all who have intelligently considered the subject. As the periodical allowance is and always will be an estimate, opinions differ as to methods and rates.

General provisions.—The regulation which follows sets forth the conditions which must be met in order to obtain the deduction for depreciation.

REGULATION. A reasonable allowance for the exhaustion, wear and tear and obsolescence of property used in the trade or business may be deducted from gross income. For convenience such an allowance will usually be referred to as covering depreciation, excluding from the term any idea of a mere reduction in market value not resulting from exhaustion, wear and tear or obsolescence. The proper allowance for such depreciation of any property used in the trade or business is that amount which should be set aside for the taxable year in accordance with a consistent plan by which the aggregate of such amounts for the useful life of the property in the business will suffice, with the salvage value, at the end of such useful life to provide in place of the property its cost, or its value as of January 1, 1919, if acquired by the taxpayer before that date. (Art. 171.)

It is proper that a taxpayer should adopt a consistent plan for depreciation and that he should adhere to it until changed conditions require an alteration. In the latter circumstances it is correct to change the percentage, but a taxpayer must be prepared to justify the basis on which the readjusted percentage is calculated.

Property which may be depreciated.—

REGULATION. The necessity for a depreciation allowance arises from the fact that certain property used in the business gradually.

approaches a point where its usefulness is exhausted. The allowance should be confined to property of this nature. In the case of tangible property, it applies to that which is subject to wear and tear, to decay or decline from natural causes, to exhaustion, and to obsolescence due to the normal progress of the art or to becoming inadequate to the growing needs of the business. It does not apply to inventories or to stock in trade; nor to land apart from the improvements or physical development added to it. It does not apply to bodies of minerals which through the process of removal suffer depletion, other provision for this being made in the statute. . . .

Property depreciated must not be for personal use.—

The deduction of an allowance for depreciation is limited to property used in the taxpayer's trade or business. No such allowance may be made in respect of automobiles or other vehicles used chiefly for pleasure, a building used by the taxpayer solely as his residence, nor in respect of furniture or furnishings therein, personal effects, or clothing; but properties and costumes used exclusively in a business, such as a theatrical business, may be the subject of a depreciation allowance. (Art. 172.)

The regulations expressly permit depreciation on all farm buildings "other than a dwelling occupied by the owner."¹

Depreciation of residence.—When a residence is used part of the year by the owner and is rented for part of the year, depreciation will be an allowable deduction for the period of the year when used for income-producing purposes. The depreciation is not necessarily based on the proportion of time during which the property is rented, as the actual depreciation during such time may be greater than during the time of occupancy by the owner. If the taxpayer owns a summer cottage and rents it for three months during the summer and occupies it personally during one month, it may be that the entire annual depreciation should be deducted, as the facts would indicate that the property as a whole is held for income-producing purposes and the occupancy by the owner for a short period is merely incidental. The test, however, would be the actual circumstances in each case.

¹Article 181; see Chapter XIX.

REGULATION. . . . No such allowance may be made in respect of . . . building used by the taxpayer solely as his residence, nor in respect of furniture or furnishings therein, personal effects, or clothing; . . . (Art. 172.)

Replacements and renewals must not be twice deducted.—

The upkeep of property ranges by imperceptible gradations from the most insignificant repairs to the replacement of the largest and most costly units. The law, of course, intends that all such expenditures shall be deducted, but the necessity arises of distinguishing between those which shall be deducted annually as expenses and those for which provision shall be made through cumulative depreciation allowances. In making this distinction, care must be taken to avoid the double deduction of expenses. The problem is complicated by the fact that minor repairs are made upon the most expensive machines. While theoretically it may be conceivable that depreciation rates might under some conditions be so delicately adjusted as to provide completely and perfectly for the entire upkeep of a machine or other piece of property, as a practical matter it is so difficult as to be impossible. The accountant's solution is to draw a somewhat arbitrary line between the small incidental items of repair, replacement and maintenance and the heavy items of renewal and replacement, charging the first group to expense and the second to depreciation reserves. The depreciation rates are calculated with this assumption in mind and consequently depreciation reserves should be kept free from charges except those for unquestioned renewals or replacements of major parts. The regulations satisfactorily cover this point in the following statement.

REGULATIONS. . . . Property kept in repair may, nevertheless, be the subject of a depreciation allowance. . . . (Art. 172.)

The cost of incidental repairs which neither materially add to the value of the property nor appreciably prolong its life, but keep it in an ordinarily efficient operating condition, may be deducted as expense, provided the plant or property account is not increased by the amount of such expenditures. Repairs in the nature of replacements, to the extent that they arrest deterioration and appreciably prolong the life

of the property, should be charged against the depreciation reserve. (Art. 113.)

For a full discussion of the distinction between repairs and depreciation, see *Income Tax Procedure*, 1921, page 845 *et seq.*

CERTAIN REPAIRS ARE PROPERLY CAPITAL EXPENDITURES.—Although it is an accepted rule that repairs and all other expenses of maintenance should be charged against profit and loss, an exception to this rule is found in cases in which partly worn-out or run-down plants are purchased with the intention on the part of the new owners to rehabilitate them so that they can be operated efficiently. It can be assumed that the purchase price takes the poor condition of the plant into consideration, and in that case the entire cost of repairs and renewals may properly be capitalized.

REGULATION. Amounts paid for increasing the capital value or for restoring the depreciated value of property are not deductible from gross income. . . . (Art. 125.)

Depreciation of intangible property.—

REGULATION. Intangibles, the use of which in the trade or business is definitely limited in duration, may be the subject of a depreciation allowance. Examples are patents and copyrights, licenses and franchises. Intangibles, the use of which in the business or trade is not so limited, will not usually be a proper subject of such an allowance. If, however, an intangible asset acquired through capital outlay is known from experience to be of value in the business for only a limited period, the length of which can be estimated from experience with reasonable certainty, such intangible asset may be the subject of a depreciation allowance, provided the facts are fully shown in the return or prior thereto to the satisfaction of the Comptroller. No depreciation is allowable with respect to good will, secret formulae or processes, trade names, trademarks or trade brands. (Art. 173.)

Depreciation of patent or copyright.—

REGULATION. In computing a depreciation allowance in the case of a patent or copyright, the capital sum to be replaced is the cost (not already deducted as current expense) of the patent or copyright or its fair market value as of January 1, 1919, if acquired prior thereto.

The allowance should be computed by an apportionment of the cost of the patent or copyright or of its fair market value as of January 1, 1919, over the life of the patent or copyright since its grant, or since its acquisition by the taxpayer, or since December 31, 1918, as the case may be. If the patent or copyright was acquired from the government, its cost consists of the various government fees, cost of drawings, experimental models, attorney's fees, etc., actually paid. Depreciation of a patent can be taken on the basis of the fair market value as of January 1, 1919, only when affirmative and satisfactory evidence of such value is offered. Such evidence should whenever practicable be submitted with the return. If the patent becomes obsolete prior to its expiration such proportion of the amount on which its depreciation may be based as the number of years of its remaining life bears to the whole number of years intervening between the date when it was acquired and the date when it legally expires may be deducted, if permission so to do is specifically secured from the Comptroller. Owing to the difficulty of allocating to a particular year the obsolescence of a patent, such permission will be granted only if affirmative and satisfactory evidence that the obsolescence occurred in the year for which the return is made is submitted to the Comptroller. The fact that depreciation has not been taken in prior years does not entitle the taxpayer to deduct in any taxable year a greater amount for depreciation than would otherwise be allowable. (Art. 177.)

Depreciation of drawings and models.—

REGULATION. A taxpayer who has incurred expenses in his business for designs, drawings, patterns, models, or work of an experimental nature calculated to result in improvement of his facilities or his product, may at his option deduct such expenses from gross income for the taxable year in which they are incurred or treat such articles as a capital asset to the extent of the amount so expended. In the latter case, if the period of usefulness of any such asset may be estimated from experience with reasonable accuracy, it may be the subject of depreciation allowances spread over such estimated period of usefulness. The facts must be fully shown in the return or prior thereto to the satisfaction of the Comptroller. Except for such depreciation allowances no deduction shall be made by the taxpayer against any sum so set up as an asset except on the sale or other disposition of such assets at a loss or on proof of a total loss thereof. (Art. 178.)

Depreciation must be entered on the books of the taxpayer.
—The state regulation in regard to record of depreciation is

specific and requires that the amount claimed as depreciation be charged off on the books of the taxpayer, if such are kept, or that a record of such deductions be maintained, if books are not kept by the taxpayer. In this respect the state regulation is more definite than the corresponding federal article 169.

REGULATION. If regular books of account are kept, a depreciation allowance, in order to constitute an allowable deduction from gross income, should be regularly charged off thereon. The particular manner in which it shall be charged off is not material, except that the amount measuring a reasonable allowance for depreciation must be either deducted directly from the book value of the assets or preferably credited to a depreciation reserve account, which must be reflected in the annual balance sheet. If regular books of account are not kept by the taxpayer a permanent record must be kept of the facts on which the claim for depreciation is based. The allowance should be computed and charged off with express reference to specific items, units or groups of property, each item or unit being considered separately or specifically included in a group with others to which the same factors apply. The taxpayer should keep such records as to each item or unit of depreciable property as will permit the ready verification of the factors used in computing the allowance for each year for each item, unit or group. (Art. 179.)

A regulation² makes specific provision for an alteration in the rate of depreciation in case the life of the property has been underestimated, but provides that it shall be done, not by reconstructing the entire depreciation history of the property with readjustments of the returns for previous years, but by distributing the remaining portion of the value not covered by depreciation over the estimated remaining life of the property. It would seem that the converse of this would also apply, viz., if the life of the property was overestimated, the rate of depreciation should be increased during the remaining years of its life sufficiently to cover the loss.

Depreciation should be based on cost or value January 1, 1919.—

REGULATION. The capital sum to be replaced by depreciation allowances is the cost of the property in respect of which the allowance

²Article 176; page 323.

is made, except that in the case of property acquired by the taxpayer prior to January 1, 1919, the capital sum to be replaced is the fair market value of the property as of that date. In the absence of proof to the contrary, it will be assumed that such value as of January 1, 1919, is the cost of the property less depreciation up to that date. To this sum should be added from time to time the cost of improvements, additions and betterments, the cost of which is not deducted as an expense in the taxpayer's return, and from it should be deducted from time to time the amount of any definite loss or damage sustained by the property through casualty, as distinguished from the gradual exhaustion of its utility which is the basis of the depreciation allowance. In the case of the acquisition after December 31, 1918, of a combination of depreciable and nondepreciable property for a lump price, as for example, land and buildings, the capital sum to be replaced is limited to that part of the lump price which represents the value of the depreciable property at the time of such acquisition. (Art. 174.)

This regulation is identical with article 164 of federal Regulations 45.

January 1, 1919, is the basic date for the value on which depreciation may be calculated. The ordinary accounting practice is to take original cost, determine a liberal depreciation rate and, when the reserve equals the cost, discontinue depreciation.

As an example of the effect of this regulation, assume that a taxpayer owned a plant which cost \$100,000 in 1900 and that prior to January 1, 1919, he had charged off \$90,000 as depreciation. Ordinarily only \$10,000 could be charged off subsequent to January 1, 1919, but if evidence can be adduced that the depreciation allowance prior to January 1, 1919, was excessive and that the fair value of the plant at that date was \$80,000, the depreciation charged off subsequent to January 1, 1919, must be based on the remaining life of the plant, using \$80,000 as the basis.

In regard to the last sentence of this regulation, it may be said that good accounting practice requires that lump sum purchases be segregated on the books of account. It is better to open too many accounts than too few, because experience demonstrates the fact that depreciation is more easily ascer-

tained by the use of a number of ledger accounts than when undivided property or plant accounts are kept.

When it is impossible definitely to allocate the cost, it should be prorated on some equitable basis or by a new appraisal made as of date of acquisition.

Modification of method of computing depreciation.—

REGULATION. If it develops that the useful life of the property has been underestimated, the plan of computing depreciation should be modified and the balance of the cost of the property, or its fair market value as of January 1, 1919, not already provided for through a depreciation reserve or deducted from book value, should be spread over the estimated remaining life of the property. No modification of the method should be made on account of fluctuations in the market value of the property from time to time, such as, on the one hand, loss in rental value of buildings due to deterioration of the neighborhood, or, on the other hand, appreciation due to increased demand. The conditions affecting such market value should be taken into consideration only so far as they affect the estimate of the useful life of the property. (Art. 176.)

Amended returns may be necessary.—It may be necessary to prepare amended returns from 1919 to the time when the adjustments are made. If the amount involved is substantial there is no other way of correcting the former erroneous practice.

The regulations are fair and reasonable in that taxpayers are required to make each year's returns include accrued depreciation for only one year. The adjustment of accounts will work out to the advantage of the government and the disadvantage of the taxpayer if the depreciation allowance is decreased during a period of high taxes, and vice versa.

When amended returns are made, depreciation should be computed on the value at January 1, 1919, instead of cost which was formerly used.

Depreciation in cases of permanent discontinuance.—

REGULATION. If the use of any property in the business is permanently discontinued, although no sale or other disposition of the

property has taken place, a determination of any gain or loss may be made; but any deduction in respect of any loss thereon must be disclosed in the taxpayer's return for the year in which the determination is made and a full statement of the facts and the basis upon which the computation is calculated must be attached to the return. Upon a sale or other disposition of the property, the consideration received shall be compared with the amount of the estimated salvage value used in computing the gain or loss as above provided, and the amount of the difference shall be treated as a gain or loss, as the case may be, of the year in which the sale or other disposition was made. (Art. 180.)

Reserves for depreciation.—The regulations³ state that “the amount measuring a reasonable allowance for depreciation must be either deducted directly from the book value of the assets or preferably credited to a depreciation reserve account, which must be reflected in the annual balance sheet.”

REGULATION. A reserve set up out of gross income by a corporation and maintained for the purpose of making good any loss of capital assets on account of depletion or depreciation is not a part of its surplus out of which ordinary dividends may be paid. A distribution made from such a reserve will be considered a liquidating dividend and will constitute taxable income to a stockholder only to the extent that the amount so received is in excess of the cost or fair market value as of January 1, 1919, of his shares of stock. No distribution, however, will be deemed to have been made from such a reserve except to the extent that the amount paid exceeds the surplus and undivided profits of the corporation. . . . (Art. 66.)

Rates of depreciation.—The law provides that a “reasonable allowance” for depreciation shall be deducted, but wisely refrains from fixing rates.

REGULATION. The capital sum to be replaced should be charged off over the useful life of the property either in equal annual installments or in accordance with any other recognized trade practice, such as an apportionment of the capital sum over units of production. Whatever plan or method of apportionment is adopted must be reasonable and should be described in the return.⁴ (Art. 175.)

³Art. 179, page 321.

⁴For an account of the various methods which can be used in the determination of depreciation, see *Income Tax Procedure*, 1921, page 857.

The Comptroller has issued the following ruling giving possible rates on certain types of buildings.

RULING. Answering your inquiry of January 3, you are advised that as the rate at which depreciation may be claimed is dependent in a greater or lesser extent upon local conditions, the use to which the property is put, and its probable life under normal conditions, no satisfactory rates at which it may be claimed can be made.

It has been estimated that the average usable life of a frame building is twenty-five years, a brick building thirty-five years, and a stone, steel or concrete building fifty to one hundred years. Having determined the probable life of the building, the taxpayer should in order to compute the amount which may be claimed as a deduction, divide its cost to him (or value on January 1, 1919, if acquired prior thereto) by the number of years it will be usable in the business in which employed, and the result thus obtained will be the amount which may be claimed each year as a deduction.

As stated above, a commonly used rate of depreciation on a frame building is four per cent, on a brick building, three per cent, and on a stone, steel or concrete building one to two per cent. (Official ruling, dated January 9, 1920.)

It should be borne in mind that the conditions outlined in the first paragraph of the ruling are really those which determine the allowance in each case.

Depreciation a local issue.—The taxpayer must take local conditions into account in considering rates of depreciation. In one locality boilers may depreciate $7\frac{1}{2}$ per cent annually; in another the rate may be 15 per cent; and the variation may be entirely legitimate. It is not merely a question of the quality of the boilers. No engineer or boiler manufacturer could give an intelligent estimate unless he knew the use to which the boiler would be subjected, the climate, the water, the class of labor, the probabilities of shut-downs, etc. A similar situation exists in the case of almost all other classes of property which depreciate by wear and tear. Therefore, wherever rates of depreciation are mentioned in this chapter, they must be taken as suggestions only and be treated as rough approximations of what depreciation may be expected under normal conditions.

Depreciation rate affected by "overtime" or "overload."—When machinery is run "overtime" there is little opportunity properly to repair and maintain the machines. Moreover, a two-shift system means divided responsibility, and with divided responsibility the machinery is sure to suffer. New workmen and those on night duty often are not so efficient as the regular staff and there is a consequent ill effect upon the machines.

Special depreciation of excessive costs.—The author has discussed at some length in *Income Tax Procedure*, 1921,⁵ the question of permitting an allowance to be made at an unusually high rate for plants erected during a period of high prices; and the reader who has been affected by such conditions is referred thereto.

Depreciation rates and practice.—The author has collected various rulings and other data regarding depreciation rates as applied to certain industries and types of depreciable property. This information, which appears in *Income Tax Procedure*, 1921,⁶ was prepared with the federal law and regulations primarily in view, but its general applicability to the state law will be recognized by reference thereto.

Depletion

The exhaustion of minerals, oils, timber, etc., by mining, flow or production of any kind must be reflected annually in the accounts of the owner in order accurately to determine the profits for the taxable year. It may be that the entire production yields a net revenue sufficient only to make proper provision for the return of the capital invested. In such case there should be nothing to pay under an income tax law.

LAW. Section 360. In computing net income there shall be allowed as deductions:

9. In the case of mines, oil and gas wells, other natural deposits and timber, a reasonable allowance for depletion and for depreciation

⁵Page 862 *et seq.*

⁶*Ibid.*

of improvements, according to the peculiar conditions in each case, based upon cost, including cost of development not otherwise deducted; provided, that in the case of such properties acquired prior to January first, nineteen hundred and nineteen, the fair market value of the property (or the taxpayer's interest therein) on that date shall be taken in lieu of cost up to that date; provided, further, that in the case of mines, oil and gas wells, discovered by the taxpayer on or after January first, nineteen hundred and nineteen, and not acquired as the result of a purchase of a proven tract or lease, where the fair market value of the property is materially disproportionate to the cost, the depletion allowance shall be based upon the fair market value of the property at the date of the discovery or within thirty days thereafter; such reasonable allowance in all the above cases to be made under rules and regulations to be prescribed by the comptroller. In the case of leases the deductions allowed by this paragraph shall be equitably apportioned between the lessor and lessee. . . .

Theory of depletion.—As with depreciation, the theory which properly determines the distinction between capital and income in dealing with depletion of natural resources is that provision must be made for the return of the original capital or cost (or value January 1, 1919) before there can be any income. This involves a periodical charge, against the gross earnings realized from the product, of such amounts as will in the aggregate equal the original outlay by the time the property shall have been exhausted. Since obviously no engineer can determine within one ton or one barrel the total contents of a mine or well, a prudent owner will base his calculation upon a scale of exhaustion somewhat more rapid than is required by the maximum estimate of the total mineral content. As soon as the reserve for depletion equals the capital investment, no further charges can be made, no matter how much more product may be recovered. The excess is all income and must be so returned.

The language of the law is broad enough to permit the full deduction demanded by the theory of depletion.

Federal principles and rules to govern.—

REGULATION. Until specific regulations on the subject of depletion are issued and promulgated by the State Comptroller, deductions

for depletion will be allowed in accordance with the principles and rules adopted by the Commissioner of Internal Revenue in regulations 45, except that the fair market value as of January 1, 1919, is the basis for claims of depletion with respect to property acquired prior to that date, and except also that claims for depletion based upon discovery must relate to discoveries by the taxpayer on or after January 1, 1919. (Art. 190.)

For a full discussion of this subject the reader is referred to *Income Tax Procedure*, 1921, Chapter XXXI.

Obsolescence

Ordinary obsolescence is usually merged with depreciation, and as such has been discussed in the foregoing pages. The allowance for extraordinary obsolescence, however, is governed by the following regulation, which is identical with the federal article 143.

REGULATION. When through some change in business conditions the usefulness in the business of some or all of the capital assets is suddenly terminated, so that the taxpayer discontinues the business or discards such assets permanently from use in the business, he may claim as a loss for the year in which he takes such action the difference between the cost or the fair market value as of January 1, 1919, of any asset so discarded (less any depreciation allowances) and its salvage value remaining. This exception to the rule requiring a sale or other disposition of property in order to establish a loss requires proof of some unforeseen cause by reason of which the property must be prematurely discarded, as, for example, where machinery or other property must be replaced by a new invention, or where an increase in the cost of or other change in the manufacture of any product makes it necessary to abandon such manufacture, to which special machinery is exclusively devoted, or where new legislation directly or indirectly makes the continued profitable use of the property impossible. This exception does not extend to a case where the useful life of property terminates solely as a result of those gradual processes for which depreciation allowances are authorized. It does not apply to inventories or to other than capital assets. The exception applies to buildings only when they are permanently abandoned or permanently devoted to a radically different use, and to machinery only when its use as such is permanently abandoned. Any loss to be deductible under this exception must be charged off on the books and fully explained in returns of income. (Art. 153.)

Extraordinary obsolescence due to prohibition.—As stated above (article 153) an exception to the rule “requiring a sale or other disposition of property in order to establish a loss” is made “where new legislation directly or indirectly makes the continued profitable use of the property impossible.”

A concrete illustration of loss occasioned by new legislation is that arising from state and national prohibition. On this point the following ruling is of interest:

RULING. Receipt is acknowledged of your letter of March 27, in which you ask whether under the provisions of the New York State Income Tax Law a reasonable value of intangible assets as good will in the liquor business will be allowed as a deduction.

The loss, if any, would be the value of such intangible assets as of January 1, 1919. A careful consideration of the conditions prevailing on January 1, 1919 leads me to conclude that such intangible assets had no value on that date.

During 1918, further manufacture of liquor was prohibited for the period of the war, thereby putting an end to the business of distilleries and manufacturers, and restricting the business to sales by dealers of stock then on hand.

The Federal constitution amendment had passed Congress and had been ratified by so large a number of States as to indicate quite clearly that complete ratification was certain within a very short time. It was therefore evident to all persons interested in the liquor business on January 1, 1919 that the trafficking in liquor would in all probability cease within a very short time. As the value of good will, trade marks and trade brands is the capitalization of the probability of the earnings from such trade brands, trade marks and good will in excess of the earnings from the sale of liquors without these factors, it is evident that no value attached to these assets on January 1, 1919, in view of the condition of prohibition legislation at that time. It is very evident that owing to this extraordinary condition, the purchaser of a liquor business on January 1, 1919 would have given no consideration to the value of such intangible assets as good will, trade marks and trade brands.

If, however, it can be shown by satisfactory proof that these intangible assets did have a value on January 1, 1919, I should allow it as a proper deduction.

If any of your clients were delayed in making their returns awaiting the receipt of the information contained herein, an extension of time will be granted upon request. (Official ruling, dated April 2, 1920.)

CHAPTER XVI

INCOME FROM PARTNERSHIPS

The state law,¹ like the federal law,² ignores the partnership as an independent entity and taxes the partners individually on their distributive shares of the income earned by the partnership, whether distributed or not.

Summary of Differences Between State and Federal Procedure

Limited partnerships of all kinds are treated as partnerships by the state. Under federal practice limited partnerships, if the shares are transferable or the liability is limited, are treated as corporations. (See page 332.)

The state treats as partnerships all organizations or associations not taxable under article 9-a of the tax law (the corporation franchise tax), even though the federal law may treat them as corporations. (See page 332.)

Personal service corporations, which under the federal law are classed as partnerships, under the state law are classed as corporations and do not have to file returns and the stockholders do not report their distributive shares. However, returns are required under the franchise tax law. (See page 332.)

If the partnership has a non-resident member and income is derived from property owned or business carried on within and without the state, an apportionment of income must be made on a special form to be filed with the partnership returns. (See Chapter XVIII.)

Partnerships are not required to file returns when all the partners are non-residents,³ and credits for income taxes paid

¹Section 364.

²Federal law, section 218 (a).

³See Chapter XVIII, "Non-Residents."

to other states, which are allowed as deductions to non-residents, are sufficient to offset the New York taxes. (See Chapter XVIII.)

Under the federal law the members of a partnership may take credit in their individual returns for their proportionate shares of foreign income taxes paid by the partnership. The state permits such a credit only to non-residents when the income so taxed arises from sources within the state of New York. (See Chapter XVIII.)

The state requires that each distribution to partners be deemed a ratable distribution of both taxable and non-taxable income. The federal rulings do not contain such a provision. (See page 335.)

Types of Partnerships

What constitutes a partnership?—Certain questions have arisen as to whether or not particular types of business relationship constitute partnerships under the law. The following rulings are of interest in this connection.

JOINT OWNERSHIP OF REAL ESTATE.—

RULING. May two joint owners of real property file a partnership return on Form 204 covering their income from this source?

Yes, or they may elect to file individual returns showing their proportionate income from such property.⁴ (Question 95, Comptroller's Questions and Answers, 1921.)

INDIVIDUAL DOING BUSINESS UNDER FIRM NAME.—

RULING. Is an individual doing business under a firm name required to file a partnership return?

No, if he is the sole proprietor, the inclusion of his income from this source on his individual return will satisfy the requirements of the law. (Question 96, Comptroller's Questions and Answers, 1921.)

⁴The federal ruling on this subject is that:

"Joint investment in and ownership of real and personal property not used in the operation of any trade or business and not covered by any partnership agreement does not constitute a partnership."

FARMING IN SHARES.—

RULING. Is it required that two persons conducting a farm on shares shall make a partnership return of such business?

If one of the parties is the owner of the farm and receives as rent, a share of the crops after the deduction of certain expenses, the elements of a partnership are not present and no partnership return is required. If, however, one party furnished money, or seed, or both, and the other furnishes labor, and both agree to share in the profits and losses, a partnership exists and a partnership return is required. (Question 122, Comptroller's Questions and Answers, 1921.)

Limited partnerships.—The state regulation makes no distinction between limited partnerships and general partnerships such as is made in the federal ruling.⁵

REGULATION. All limited partnerships, whether of the type authorized by the statutes of New York and Illinois or of Pennsylvania and Michigan and most other states, are partnerships and not corporations within the meaning of the statute. (Art. 227.)

Associations as partnerships.—The state regulation classes all associations and organizations not subject to the New York corporation franchise tax (article 9-a of the tax law) as partnerships, although for federal purposes such associations may be considered corporations.

REGULATION. An organization, the partnership interests in which are not transferable without the consent of the members, is a partnership and not an association. Any so-called association or organization not taxable under article 9-a of the Tax Law and not exempted under such article, will be regarded as a partnership within the meaning of the Income Tax Law. The members of such partnerships will be required to include in their returns their share of the profits of such partnerships, whether distributed or undistributed. Such partnerships will be required to file returns in the same manner as all other partnerships. (Art. 228.)

Personal service corporations not treated as partnerships.—

RULING. Answering your inquiry of November 17th, you are

⁵*Income Tax Procedure*, 1921, page 627.

advised that the personal income tax law of New York State does not impose a tax on corporations and so far as the administration of the law is concerned, it does not distinguish between personal service corporations and other corporations.

The distributive income of personal service corporations is not taxable as partnership income in the manner outlined in the Federal Law. The administration of the corporation tax law is vested in the State Tax Commission and you are referred to that commission for specific information relative to such law. (Official ruling, dated November 18, 1919.)

Stockholders should report only the amount of dividends received from the corporation during the year, with any salary that may have been drawn.

Net Income of Partners—How Determined

The general provisions of the state law governing the taxation of partnerships are identical with those of the federal law.⁶

LAW. Section 364. Individuals carrying on business in partnerships shall be liable for income tax only in their individual capacity. There shall be included in computing the net income of each partner his distributive share, whether distributed or not, of the net income of the partnership for the taxable year, or, if his net income for such taxable year is computed upon the basis of a period different from that upon the basis of which the net income of the partnership is computed, then his distributive share of the net income of the partnership for any accounting period of the partnership ending within the fiscal or calendar year upon the basis of which the partner's net income is computed. . . .

This section of the law has been elaborated, as in the case of the federal rulings, by the following:

REGULATION. . . . Amounts earned and distributed to a partner by a partnership after the end of its taxable year and before the end of his corresponding taxable year should be accounted for both by the partnership and by the partners in their returns for their next succeeding taxable years. (Art. 229.)

The partnership return is simply an information return which shows: (1) the various items of income and deduction,

⁶Federal law, section 218 (a).

taxable and non-taxable income, allowable and non-allowable deductions; (2) the distributive shares of the partners; (3) when apportionment is necessary,⁷ the portion of taxable income allocated to the state of New York.

"Net income of a partnership" defined.—The state law provides for computation of net income of a partnership on the same basis as that for an individual and follows the federal law.⁸

LAW. Section 364. . . . The net income of the partnership shall be computed in the same manner and on the same basis as provided in computing the net income of individuals except that the deduction provided in subdivision ten of section three hundred and sixty shall not be allowed and the personal exemptions provided for in section three hundred and sixty-two shall be allowed only to the individual partners.

CHARITABLE CONTRIBUTIONS.—The foregoing simply means that if a partnership's income, after deducting \$500 of contributions, was \$20,000, and there were two partners sharing profits equally, each would report as income from the partnership one-half of \$20,500, or \$10,250, and then claim as a deduction for contributions one-half of \$500, or \$250, assuming of course that his contributions made individually, with the \$250 mentioned, did not exceed 15 per cent of his net income from all sources before deducting contributions.

REGULATION. In computing the net income of partnerships, charitable contributions may not be deducted. Each partner may, however, take as a deduction on his personal return his proportionate share of the charitable contributions made by the partnership, subject to the limitations contained in article 201.⁹ (Art. 233.)

CREDITS FOR CERTAIN DIVIDENDS AND INTEREST.—It is not necessary under the state law, as it is under federal practice,¹⁰ to ascertain the amount of dividends and Liberty bond interest, so as to allow each partner to credit his proportionate

⁷See Chapter XVIII.

⁸Federal law, section 218 (d).

⁹See page 278.

¹⁰Federal law, section 218 (a).

share for the purpose of the federal normal tax; but it is necessary to know the amount of interest on obligations of the United States, as such interest, while only partly exempt under the federal law, is totally exempt under the state law.¹¹ The instructions on form 204¹² repeat the words found in article 226.¹³

Every distribution or credit shall be deemed to be a ratable distribution of income of each kind (taxable and non-taxable) received during the year.

CREDIT FOR FOREIGN INCOME AND PROFITS TAXES.—Under the federal law¹⁴ an individual partner is permitted to credit a proportionate share of any foreign income and profits taxes paid by the partnership against the amount of his individual income taxes. There is no similar provision in the state law as far as residents are concerned. (As to non-residents, see Chapter XVIII.) Such taxes may not be deducted in computing net income.¹⁵

DEDUCTION FOR PARTNERSHIP LOSSES.—Partnership losses are deductible in the returns of the individual partners.¹⁶

If the distributive share on the firm's books is a net profit, but the total of exempt income¹⁷ is greater than the net profit, the difference is allowable as a loss in the individual partner's returns.

PARTNERS' SALARIES.—So-called salaries paid to partners are in effect a distribution of anticipated profits. They may, however, have been deducted on the partnership books in determining the annual net profits distributable at the end of the fiscal year. *If so deducted* such salaries should be included as taxable income, for the year in which received, in

¹¹See page 41.

¹²Instructions E 1, page 1 of instructions.

¹³See page 226.

¹⁴Federal law, section 222 (a).

¹⁵Section 360, 3; page 292

¹⁶Article 151.

¹⁷See Chapter III.

each partner's individual return, in addition to his remaining share of the partnership profits for the fiscal year.

The accounting period.—A partner is permitted to report on a calendar year or other fiscal year basis.¹⁸ If desired, the basis may be changed from calendar year to fiscal year, fiscal year to calendar year, or one fiscal year to another.¹⁹

A person who is a partner in one or more firms must report his share of the partnership profits for twelve months ended during his own fiscal year, whether the profits were distributed or not.

Fiscal year ended in 1919.²⁰—

REGULATION. If the fiscal year of a partnership began in the calendar year 1918 and ended in the calendar year 1919, the tax for the calendar year 1919 applies to the amount of each partner's distributive share of such net income of the partnership attributable to the calendar year 1919. The amount of each partner's distributive share of the net income of the partnership for such fiscal year attributable to the calendar year 1919 is found by determining the net income of the partnership for its entire fiscal year in accordance with the law and the distributive share thereof of each partner, and then taking such proportion of that distributive share as the part of the fiscal year falling within the calendar year 1919 bears to the full fiscal year. (Art. 232.)

To illustrate, a partnership for its fiscal year ended April 30, 1919, had net income of \$20,000. A and B, the partners, share profits on the basis of 60 and 40 per cent, respectively. A would compute his distributive share for the entire period, 60 per cent of \$20,000, or \$12,000, and report in his individual return for 1919 one-third (ratio of number of months in 1919 to 12) of \$12,000, or \$4,000.

Procedure when personal and partnership accounts are on different bases.—It is immaterial whether a taxpayer keeps

¹⁸See page 152.

¹⁹See page 70.

²⁰[**Former Procedure**] The Comptroller required two returns, one for the entire fiscal year and the other from January 1, 1919, to the end of the fiscal year. *Income Tax Procedure*, 1920, page 956.

his personal accounts on the cash basis or by the accrual method. He must report in his individual return his distributive share of the partnership income for the partnership's accounting period which ended during his taxable year.

RETURNS OF RESIDENT PARTNERS. —

LAW. Section 364. . . . **Taxpayers who are members of partnerships may be required by the comptroller to make a return stating the gross receipts and net gains or profits of the partnership for any taxable year. . . .**

The state, of course, has no jurisdiction over a partnership business entirely without the state, but a resident of New York, who is a member of such a partnership, is required to report his distributive share of profits from the partnership and may even be called upon to make a return of income of the partnership.

REGULATION. . . . Resident individuals who are members of partnerships may be required by the Comptroller to make a return stating the gross receipts and the net gains or profits of the partnership for the taxable year.

A resident member of a partnership must include in his return his distributive share of the profits of such partnership even though it do no business within the State of New York and derive no income from sources within the State.

Every distribution (or credit) shall be deemed to be a ratable distribution of income of each kind received during the year. (Art. 226.)

Dissolution or changes of partnership.—

REGULATION. When a partner retires from a partnership, or it is dissolved, he realizes a gain or loss measured by the difference between the price received for his interest and the cost to him or (if acquired prior thereto) the fair market value as of January 1, 1919, of his interest in the partnership, including in such cost or value the amount of his share in any undistributed partnership net income earned since December 31, 1918, on which the income tax has been paid. If, however, the partnership distributes its assets in kind and not in cash, the partner realizes no gain or loss until he disposes of the property received on distribution. . . . (Art. 101.)

The foregoing is identical with the federal ruling, except-

ing that the dates are March 1, 1913, and February 28, 1913, respectively.

There is neither gain nor loss in the distribution upon the basis of book values, because the partners have already been taxed as individuals upon the partnership gains. When the business of the partnership in dissolution is continued a partner may await the result of the transactions for the entire taxable year before taking up in his accounts any gain or loss.

When a partner realizes cash or the equivalent of an amount greater or less than his capital account shown by the partnership books, the foregoing regulation will apply. The item of goodwill, if not on the books, should always be considered.

READJUSTMENT OF PARTNERSHIP INTERESTS.—Sometimes a continuing partner purchases a retiring partner's interest for less than the amount shown by the capital account of the latter. In such case the continuing partner realizes no profit unless and until he converts the assets into the equivalent of cash. In other words, there can be no realized profit from a purchase of partnership interest.

CHAPTER XVII

FIDUCIARIES

The state law relative to the tax liability of fiduciaries differentiates between resident estates and trusts and non-resident estates and trusts. The taxable status of fiduciaries corresponds in a large measure with the taxable status of individuals. In the main the federal law has been followed. Such differences as exist between the two laws are noted below.

A fiduciary is one who occupies a position of peculiar confidence and trust toward others. He is not merely a confidential agent; and no power of attorney can, of itself, create the fiduciary relation. In some cases a fiduciary has legal title to the property and those for whom he is acting enjoy the beneficial title, but this is not a universal rule.¹

Summary of Differences Between State and Federal Procedure

Under the state rulings the classification of an estate or trust as a resident or non-resident depends upon the place of residence of the decedent at time of death or the residence of the creator of the trust. Under federal practice the place of residence of the fiduciary governs. (See page 342.) This is an important distinction because non-resident estates or trusts are taxed as non-resident individuals.

The state permits the actual fact of distribution to govern in determining whether the fiduciary or the beneficiary shall pay the tax in cases in which it is optional for the trustee to distribute income or to accumulate it. (See page 345.)

The basis for ascertaining profit or loss on the sale of property under state procedure is the fair market value at January 1, 1919, if the decedent died or the trust was created

¹Exceptions are, among others, administrators and bankruptcy receivers.

prior to that date. The corresponding date for federal purposes is March 1, 1913. (See page 353.)

General

Fiduciary defined.—

Law. Section 350. . . .

5. The word "fiduciary" means a guardian, trustee, executor, administrator, receiver, conservator, or any person, whether individual or corporate, acting in any fiduciary capacity for any person, trust or estate. . . .

REGULATION. "Fiduciary" is a term which applies to all persons that occupy positions of peculiar confidence and trust toward others, such as guardians, trustees, executors, administrators, receivers, conservators or any other person, whether individual or corporate, acting in any fiduciary capacity for any person, trust or estate. A committee of the property of an incompetent person is a fiduciary. (Art. 240.)

Fiduciary distinguished from agent.—

REGULATION. There may be a fiduciary relationship between an agent and a principal, but the word "agent" does not denote a fiduciary. A fiduciary relationship cannot be created by a power of attorney. An agent having entire charge of property, with authority to effect and execute leases with tenants entirely on his own responsibility and without consulting his principal, merely turning over the net profits from the property periodically to his principal by virtue of authority conferred upon him by a power of attorney, is not a fiduciary within the meaning of the statute. In cases where no legal trust has been created in the estate controlled by the agent and attorney the liability to make a return rests with the principal. (Art. 241.)

It has been decided that the Alien Property Custodian is merely an agent or officer of the government and is not a fiduciary as defined by the law and regulations. He is not required to make returns or to pay taxes on the property in his hands, but he will, of course, indicate to the Treasury the taxes due so that they can be collected before the property is returned to the alien owner.

Classification of estates and trusts.—

LAW. Section 365. 1. The tax imposed by this article shall apply to estates and trusts, which tax shall be levied, collected and paid

annually upon and with respect to the income of estates or of any kind of property held in trust, including:

Income subject to tax.—

a. **Income received by estates of deceased persons during the period of administration or settlement of the estate.**

b. **Income accumulated in trust for the benefit of unborn or unascertained persons or persons with contingent interests.**

c. **Income held for future distribution under the terms of the will or trust;**

d. **Income which is to be distributed to the beneficiaries periodically, whether or not at regular intervals, and the income collected by a guardian of an infant to be held or distributed as the court may direct; and**

e. **Income of an estate during the period of administration or settlement permitted by subdivision three to be deducted from the net income upon which the tax is to be paid by the fiduciary. . . .**

REGULATION. For the purpose of the income tax, income of estates and trusts may be divided into two classes:

First.—Income, the tax upon which is imposed upon the estate or trust and the tax paid by the fiduciary, consisting of

(a) Income received by estates of deceased persons during the period of administration or settlement except as provided in "f" below;

(b) Income accumulated in trust for the benefit of unborn or unascertained persons or persons with contingent interests;

(c) Income held in trust for future distribution under the terms of the will or trust.

Second.—Income, the tax upon which is imposed upon and paid by the beneficiaries, consisting of

(d) Income which is to be distributed to beneficiaries periodically whether or not at stated intervals;

(e) Income collected by the guardian of an infant to be held or distributed as the court may direct;

(f) Income of the estate of any deceased person which during the period of administration or settlement is properly paid or credited to any legatee, heir or other beneficiary. (Art. 242.)

This article does not appear in the federal regulations. While it repeats the classification of section 365 (1), of the law, it distinguishes very clearly the classes of estates and trusts on which tax will be paid by the fiduciary and those for which the fiduciary files merely an information return and the tax is paid by the beneficiary. The basic theory underlying the dis-

tion is that the income in classes (a), (b) and (c), if retained by the fiduciary without tax, might delay payment of tax to the state—in fact until the beneficiary actually received his distributive share. Therefore the state taxes such income retained in the hands of the fiduciary and makes the fiduciary pay the tax due. The remaining classes, (d), (e) and (f), can be taxed readily in the hands of the beneficiary.

Resident and non-resident estates and trusts distinguished.—

REGULATION. For the purpose of the income tax estates and trusts are (a) resident estates and trusts or (b) nonresident estates and trusts. If the decedent was at the time of his death a resident of New York State, his estate is a resident estate and any trust created by his will is a resident trust. If the decedent was at the time of his death a nonresident, his estate is a nonresident estate and any trust created by his will is a nonresident trust. If the creator of a trust was at the time the trust was created a resident of New York State, the trust is a resident trust. Conversely, if the creator of a trust was at the time the trust was created a nonresident of the State, the trust is a nonresident trust. The residence or situs of the fiduciary does not in any sense control in the classification of estates and trusts as resident or nonresident. (Art. 243.)

This regulation is not paralleled by a federal regulation. It should be noted that the personal classification of the fiduciary has no bearing on the question of whether the estate or trust for which he is acting is to be classed as resident or nonresident. The controlling factor in the case is the residence of the decedent at the time of his death, or in the case of a trust, the residence of the creator of the trust at the time when the trust was created. Under federal practice the residence of the fiduciary governs.

Basis of taxation of estates and trusts.—

REGULATION. If such an estate or trust is a resident as defined in article 243 its income from all sources both within and without the State is taxable. If the estate or trust is a nonresident as defined in article 243, only its income from sources within the State (exclusive of annuities, interest on bank deposits, interest on

bonds, notes or other interest-bearing obligations or dividends from corporations, except to the extent to which the same shall be a part of income of any business, trade, profession or occupation carried on in this State subject to taxation) is taxable. In the case of an estate or trust taxed as provided in this article, a personal exemption of \$1,000 is allowed against income subject to tax. . . . (Art. 244.)

Duties of Fiduciaries

Fiduciary to pay tax.—

LAW. Section 365. . . .

3. In cases under paragraphs a, b, and c of subdivision one, of this section, the tax shall be imposed upon the estate or trust with respect to the net income of the estate or trust and shall be paid by the fiduciary, ...

The classes of estates and trusts mentioned above as (a), (b) and (c) are defined on page 341. For estates of these classes tax returns are filed on form 200 or 201 for resident estates or trusts and on form 203 for non-resident estates or trusts.²

Liability for tax on estate or trust.—

REGULATION. Liability for payment of the tax attaches to the person of an executor or administrator up to and after his discharge, where prior to distribution and discharge he had notice of his tax obligation or failed to exercise due diligence in determining whether or not such obligation existed. Liability for the tax also follows the estate itself, and when by reason of the distribution of the estate and the discharge of the executor or administrator it appears that collection of the tax cannot be made from the executor or administrator, the legatees or distributees must account for their proportionate share of the tax due and unpaid. The same considerations apply to other trusts. Where the tax has been paid on the net income of an estate or trust by the fiduciary, such income is free from tax when distributed to the beneficiaries. (Art. 255.)

This regulation, identical with federal article 344, shows how important it is for a fiduciary to make allowance for taxes due before closing an estate. Should it happen that, without any negligence on the part of the fiduciary, the tax should be underpaid, the liability would follow the estate into

²See further, page 348. For forms see Appendix A.

the hands of the beneficiaries, from whom the additional assessment could be collected.

“Period of administration” defined.—

REGULATION. The “period of administration or settlement of the estate” is the period required by the executor or administrator to perform the ordinary duties pertaining to administration, in particular the collection of assets and the payment of debts and legacies. It is the time actually required for this purpose, whether longer or shorter than the period specified in the local statute for the settlement of estates. Where an executor, who is also named as trustee, fails to obtain his discharge as executor, the period of administration continues up to the time when the duties of administration are complete and he actually assumes his duties as trustee, whether pursuant to an order of the court or not. (Art. 253.)

This article corresponds to federal article 343.

In regard to the deduction of expenses during the period of administration, see article 254, page 355.

Basis of taxation to fiduciary.—

REGULATION. In the case of estates or trusts falling within subdivisions a, b, and c of article 242,³ the fiduciary is required to make return on Form 200 or 201 as prescribed in article 246 and pay the tax on the taxable income of such estate or trust. The imposition of the tax is not affected by the fact that an ultimate beneficiary may be a person not subject to tax. Where under the terms of the will or deed, the trustee may in his discretion distribute the income or accumulate it, the amount actually distributed is taxable to the beneficiary, and the amount accumulated is taxable to the fiduciary.

. . . . If such an estate or trust is a resident as defined in article 243 its income from all sources both within and without the State is taxable. If the estate or trust is a nonresident as defined in Article 243, only its income from sources within the State (exclusive of annuities, interest on bank deposits, interest on bonds, notes or other interest-bearing obligations or dividends from corporations, except to the extent to which the same shall be a part of income of any business, trade, profession or occupation carried on in this State subject to taxation) is taxable. In the case of an estate or trust taxed as provided in this article, a personal exemption of \$1,000 is allowed against income subject to tax. (Art. 244.)

³Defined on page 341.

This regulation corresponds with federal article 342, but the difference is very vital.

The federal regulation provides :

. . . . Where under the terms of the will or deed the trustee may in his discretion distribute the income or accumulate it, the income is taxed to the trustee, irrespective of the exercise of his discretion.

But the state has wisely permitted the fiduciary to be bound by the actual facts if this power is exercised. Thus the onus will be on the beneficiary if a distribution is actually made, but on the fiduciary if the income is retained.

The following ruling is of interest as it bears upon the provision that although the ultimate beneficiary, e.g., a remainderman, may not be subject to tax, that fact will not affect the imposition of the tax on the estate.

RULING. In an estate in which the will provided that after the death of certain beneficiaries the residue was to be given to the city of Rochester for the purpose of erecting a municipal art museum, the question has arisen whether or not the income of such estate during administration and settlement is taxable under the personal income tax law?

Yes, the executor would be required to pay a tax upon the income not distributed to the beneficiaries. Section 365 of the law imposes a tax upon income received by estates during the period of administration and settlement. Unquestionably it was the legislative intent to impose a tax upon the entire income of estates during this period irrespective of whether or not a residuary legatee was to receive a part of the income as his or its distributive share of the corpus of the estate. This is not an actual imposition of the tax upon the city of Rochester, the residuary legatee, because that municipality is not entitled to the property until certain conditions are fulfilled, at which time the amount of the residuary estate is paid over to the city. Until that time, his property is vested in the estate, the income of which is taxable under the provisions of section 365 of the statute. (Question 91, Comptroller's Questions and Answers, 1921.)

It is very doubtful whether or not the foregoing ruling would hold if the amounts not distributed to the life tenants did not in fact belong to them. In such a case it could be held that all surplus income was earmarked for payment to the city

of Rochester and under section 365(2)⁴ of the law would be non-taxable.⁵

Returns of income to be made by fiduciaries.—

LAW. Section 365. . . .

2. The fiduciary shall be responsible for making the return of income for the estate or trust for which he acts, whether such income be taxable to the estate or trust or to the beneficiaries thereof. . . .

Under this section of the law either returns on which tax is to be paid or information returns are required from the fiduciary.

LAW. Section 369. . . .

3. . . . The return made by a fiduciary shall state specifically the items of the gross income and the deductions, exemptions and credits allowed by this article. Under such regulations as the comptroller may prescribe, a return made by one of⁶ two or more joint fiduciaries shall be a sufficient compliance with the above requirement. The fiduciary shall make oath that he has sufficient knowledge of the affairs of the individual, estate or trust for whom or which he acts to enable him to make the return, and that the same is, to the best of his knowledge and belief, true and correct.

Fiduciaries required to make returns under this article shall be subject to all the provisions of this article which apply to taxpayers.

Types of fiduciary returns.—

LAW. Section 369. Every fiduciary (except receivers appointed by authority of law in possession of part only of the property of a taxpayer) shall make under oath a return for the individual or estate or trust for whom he acts, as follows:

FIDUCIARY ACTING FOR INDIVIDUAL.—

1. If he acts for an individual whose entire income from whatever source derived is in his charge and the net income of such individual is one thousand dollars or over if single, or if married and not living with husband or wife, or two thousand dollars or over if married and living with husband or wife.

⁴See page 355.

⁵See *Lederer v. Stockton*, 266 Fed. 676, quoted in *Income Tax Procedure*, 1921, page 1048.

⁶Law reads "or."

DECEDENT'S ESTATE DURING ADMINISTRATION.—

2. If he acts (a) for an estate of a deceased person during the period of administration or settlement, whether or not the income of such estate during such period of administration or settlement is properly paid or credited to any legatee, heir or other beneficiary;

ESTATE INCOME ACCUMULATED IN TRUST.—

(b) for an estate or trust the income of which is accumulated in trust for the benefit of unborn or unascertained persons, or persons with contingent interests;

ESTATE INCOME HELD FOR FUTURE DISTRIBUTION.—

or (c) for an estate or trust the income of which is held for future distribution under the terms of the will or trust; and the net income of such estate or trust is one thousand dollars or over.⁷

ESTATE INCOME DISTRIBUTED PERIODICALLY.—

3. If he acts (a) for an estate or trust the income of which is to be distributed to the beneficiaries periodically;

GUARDIAN OF INFANT BENEFICIARY.—

or (b) as the guardian of an infant whose income is to be held or distributed as the court may direct; and any beneficiary of such estate or trust receives or is entitled to a distributive share of the income of the estate or trust of one thousand dollars or more.⁸ . . .

The following article reclassifies the types of estates mentioned above so as to indicate clearly when returns on which tax is to be paid by the fiduciary are required and when information returns alone must be filed.

REGULATION. Every fiduciary or at least one of joint fiduciaries (except receivers appointed by authority of law, in possession of part only of the property of the taxpayer) is required to make a return of income for the individual or trust or estate for whom he acts (either (1) as a tax return or (2) as an information return) as follows:

I. TAX RETURNS—

The fiduciary of every trust or estate must make a return, on Form 200 or 201, and of every nonresident trust or estate on Form 203 for nonresident trusts and estates, and pay the tax on the taxable

⁷The provision regarding income over \$1,000 applies to 2 (a), (b) and (c).

⁸The last clause refers to both 3 (a) and (b).

income of each trust or estate taxed as an entity having a net income of \$1,000 or over during the taxable year in the case of:

- (a) Income received by estates of deceased persons during the period of administration or settlement.
- (b) Income accumulated in trust for the benefit of unborn or unascertained persons, or persons with contingent interests;
- (c) Income held for future distribution under the terms of a will or trust.

In (a) the fiduciary is entitled to deduct the amount of income properly paid or credited to any beneficiary.

The fiduciary of an estate or trust is entitled to the personal exemption of \$1,000 in ascertaining the tax liability of the estate or trust.

In the absence of any specific allocation of income under the will or deed of trust, every distribution shall be deemed to apply ratably to taxable and nontaxable income of the estate or trust.

2. INFORMATION RETURNS—

The fiduciary of every estate or trust (resident or nonresident) must make an information return on Form 205 if any beneficiary receives or is entitled to a distributive share of taxable income of \$1,000 or over during the taxable year in the following cases:

- (a) Income which is to be distributed to beneficiaries periodically, whether or not at stated intervals;
- (b) Income collected by the guardian of an infant, to be held or distributed as the court may direct;
- (c) Income of the estate of any deceased person, which during the period of administration or settlement, is properly paid or credited to any legatee, heir or other beneficiary.

In the absence of any specific allocation of income, under the will or deed of trust, every distribution shall be deemed to apply ratably to taxable and nontaxable income of the estate or trust and the beneficiary must be guided by the same allocation.

No tax is to be paid by the fiduciaries on these returns as the income is taxable to the beneficiaries, but there shall be included in computing the net income of each beneficiary his distributive share, whether distributed or not, of the net income of the estate or trust for the taxable year.⁹

If the estate or trust (a) has a nonresident beneficiary and (b) carries on business (as "business carried on" is defined in article 415), both within and without the State of New York, the fiduciary shall accompany his return with a schedule of apportionment on Form 205a. (Art. 246.)

⁹See also section 365, 2, of the law.

It should be noted that if an estate receives and distributes both taxable and non-taxable income, the amounts distributed are to apply ratably to the taxable and non-taxable income. For an illustration of such a distribution, see Appendix A.

A beneficiary's distributive share which is to be reported must be ascertained in accordance with the tax law and regulations. This provision (contained in article 252, page 353) may cause the aggregate of the distributive shares of an estate to exceed the net income.

When there is a non-resident beneficiary and, in the technical sense under the law, business is conducted by the estate within the state of New York, the fiduciary is required to apportion the income within and without the state on form 205-A.

RETURNS WHERE MORE THAN ONE TRUST.—

REGULATION. In the case of two or more trusts the income of which is taxable to the beneficiaries, which were created by the same person and are in charge of the same trustee, the trustee may at his option make a single return on Form 205 for all such trusts, notwithstanding that they may arise from different instruments. When, however, a trustee holds trusts created by different persons for the benefit of the same beneficiary he shall make a return on Form 205 for each trust separately. (Art. 249.)

RETURN BY GUARDIAN OR COMMITTEE.—

REGULATION. A fiduciary acting as the guardian of a minor or as the committee of an incompetent person must make a return of income for such person, whose entire income is in charge of such fiduciary, if the net income of such person is \$2,000 or over if living with husband or wife, or \$1,000 or over in other cases. If such person is a resident the return shall be made on Form 200 or 201, and if a nonresident, the return shall be made on Form 203. In such cases the fiduciary must pay the tax as shown by the return to be due. (Art. 248.)

RETURN BY RECEIVER.—

REGULATION. A receiver who stands in the stead of an individual must render a return of income on Form 200 or 201 and pay the tax for his trust, but a receiver of only part of the property of an individual need not do so. A receiver in charge of the business

of a partnership shall render a return on Form 204. A receiver appointed to hold and operate a mortgaged parcel of real estate, to whom rents and profits are paid, but who is not in control of all the property or business of the mortgagor, and a receiver in partition proceedings, are not required to render returns of income. In general statutory receivers and common law receivers of all the property or business of an individual must make returns. (Art. 250.)

RETURN OF INDIVIDUAL'S INCOME IN CHARGE OF FIDUCIARY.—

REGULATION. Every fiduciary must make a return of income for every individual whose entire income is in charge of such fiduciary, if the net income of such individual is \$2,000 or over, if living with husband or wife, or \$1,000 or over in other cases. If such individual is a resident, the return shall be made on Form 200 or 201, and if he is a nonresident, the return shall be made on Form 203. In such cases, the fiduciary must pay the tax shown by the return to be due. (Art. 247.)

This obligation of a fiduciary is quite distinct from his duties to the estate. It refers to a different state of affairs, namely, that existing when a beneficiary has appointed the fiduciary as his agent or attorney in fact and as such requires him to prepare the beneficiary's tax return. The fiduciary's liability so far as the estate is concerned ends when he has filed forms 200, 201, 203, 205 or 205-A, as may be required, and has paid the tax when the estate itself is taxable.

Time for filing returns upon death or termination of trust.—

REGULATIONS. As soon as possible after his appointment and qualification, without waiting for the close of the taxable year, an executor or administrator may file a return of income for the decedent. Upon the completion of the administration of an estate and final accounting an executor or administrator shall file a return of income of the estate for the portion of the taxable year in which the administration was closed. An ancillary administrator need make no separate return if the domiciliary administrator includes in his return the entire income of the estate. Similarly, upon the termination of any other trust the trustee may make a return without waiting for the close of the taxable year. In any such case the tax must be paid at the time the return is filed. The payment of the tax before the

end of the taxable year in such circumstances does not relieve the taxpayer from liability for any additional tax which may subsequently be imposed upon income of the taxable year. (Art. 542.)

. . . . If an individual dies during the taxable year, his executor or administrator in making a return for him is entitled to claim his full personal exemption according to the status of the decedent. If a husband or wife so dies and the joint personal exemption is used by the executor or administrator in making a return for the decedent, an undiminished personal exemption according to the status of the survivor during his (or her) taxable year subsequent to such death, may be claimed in the survivor's return. (Art. 209.)

It will be seen that the executor or administrator has a primary duty to prepare and file a tax return for the decedent to cover the period from the date of the decedent's last return to the date of his death. This return will be prepared either on a cash or an accrual basis as the decedent would have compiled it, excepting that the exemption of \$1,000 or \$2,000 is taken in full, however short the period may be. Should the net income not exceed \$1,000, no return is necessary; and, what is even more important, the income does not have to be considered in a later return by the fiduciary.

At the termination of the period of administration a further return for that period must be filed by the fiduciary if the net income during the period of administration exceeds \$1,000. An exemption of \$1,000 is to be claimed, however short a period the return covers. Credit is also allowed for any payments made to beneficiaries and the deduction for charitable contributions is not limited to 15 per cent as it is in the case of individuals. Income which is ordinarily exempt in the hands of individuals, such as proceeds of life insurance, municipal and other exempt bond interest, is also exempt when received by an estate. See also article 253, page 344.

Income Taxable in Hands of Fiduciary

LAW. Section 365.

2. The net income of an estate or trust shall be computed in the same manner and on the same basis as provided in this article for individual taxpayers, ...

Article 246 (1)¹⁰ indicates the kinds of estates which are taxable in the hands of the fiduciary. The basis of computation of net income on which the fiduciary has to pay tax must be considered also.

Resident estates or trusts will be taxed like resident individuals (with some exceptions) and non-resident estates or trusts like non-resident individuals.¹¹

Deductions allowed to fiduciaries.—

REGULATION. . . . In the case of certain estates and trusts it is recognized that the estate or trust cannot be treated as a unit for income tax purposes and may represent an aggregate of distinct interests to all of which the fiduciaries are responsible; in such cases the procedure stated in this ruling should govern. The following are recognized as cases which can not be treated as a unit and must, therefore, be governed by this ruling: (a) When there is income distributable periodically and also income which is to be accumulated in trust held for future distribution, or added to the corpus; (b) when there is income distributable periodically, e.g., gains from sale of capital assets; (c) when there is income distributable periodically and deductions (according to the law and regulations) which are not deductible under provisions of the will or trust from the distributable income, e.g., losses from the sale of capital assets, bad debts, depletion, depreciation and other deductions which are not actual payments out of income.

In ascertaining whether an estate or trust comes within any one of the cases just enumerated, the provisions of the income tax law and regulations—rather than the provisions of the will or trust—shall determine what items constitute taxable gross income or allowable deductions; the provisions of the will or trust shall determine the allocation of items of gross income or deductions; that is to which of the different interests making up the whole such items shall be charged or allowed. In cases which are to be treated under this article, the items of gross income and deduction as determined by the law and regulations must be scrutinized and classified in accordance with the provisions of the will or trust into two classes, one subject to the procedure specified in subdivision (3) of section 365, and the other to the procedure specified in subdivision (4) of section 365. The result will be that the beneficiary to whom income is to be distributed periodically must include in computing his net income the amount actually distributable to him (except exempt income) even

¹⁰See page 347.

¹¹See article 244, page 342.

though the aggregate of the distributive shares should be larger than the net income of the estate or trust computed as a unit. The amount distributable to the beneficiary includes the entire amount to which he is entitled under the provisions of the will or trust even if not paid or credited to him during the taxable year. Any gain, profit, or income which is not periodically distributable, must be included in computing the net income of the estate or trust so that the fiduciary will pay the tax upon any excess of the net income of the estate or trust computed as a unit over the aggregate distributive shares.

Losses and gains from the sales by fiduciaries of property included in the original trust or estate.—

The profit or loss from the sale or other disposition of property included in the original trust or estate is the difference between the sales price and the fair market value of the property at the time of decedent's death or at the date of the creation of the trust, unless the decedent's death occurred or the trust was created prior to January 1, 1919, in which case the fair market value upon that date is the basis for determining loss or gain. Profit derived from the sale or other disposal of assets of estates or trusts even though considered as a capital asset of the trust or estate, is taxable income, and taxable to the beneficiaries, if paid or credited to them, or to the estate or trust as an entity, if not so paid or credited; likewise, losses from the sale of capital assets are allowable deductions from the gross income of the estate or trust. . . . (Art. 252.)

This regulation provides for the determination of profit or loss on the sale of property included in the original estate. The basic value is that of January 1, 1919, or that of the date of the decedent's death or the creation of the trust, if this occurred subsequent to January 1, 1919.

As will be seen later,¹² "the gain and loss on the sale of capital assets will be considered capital items affecting the corpus only," and the question of who pays the tax on gains is determined by the provision of the will or deed of trust.¹³ If the fiduciary is required to distribute the profit from sales of capital assets, the tax must be borne by the beneficiary. If such profit is not to be distributed the fiduciary must pay the tax from the capital funds in his possession.

¹²See article 252, page 361.

¹³See the author's comment, *Income Tax Procedure*, 1921, page 1045 et seq.

The following answer does not seem to be in accord with the regulation quoted above.

RULING. In the sale of an apartment house a profit of \$10,000 was realized. This property is owned by an estate, the income of which is distributable to a life tenant and a remainderman. How is this income taxable to these respective interests?

By charging to the life tenant and remainderman the proportion of the amount realized based on their interests in the property. For instance, if the life tenant at time of realization of this income was 45 years of age his normal use of the property could be computed by his expectancy of life as determined by standard tables of mortality. This number of years multiplied by the yearly value of the property to the life tenant would then produce an actual figure showing his vested interest in the property. After determination of his share of the \$10,000 income computed on this basis, the balance of the amount realized from the sale would be considered as income to the remainderman. (Question 87, Comptroller's Questions and Answers, 1921.)

The apartment house is part of the corpus of the estate, the income from which is distributed to the life tenant and either the corpus or the income from the corpus will be distributed to the remainderman on the death of the life tenant. If the life tenant is entitled to the profit on the sale of assets, the tax on such profit should be paid in its entirety by the life tenant, but if such profit is not distributable to the life tenant, the fiduciary should pay the tax from the corpus of the estate. In neither case would the remainderman be liable for the tax. See also paragraph (2) of the ruling quoted on page 345.

Credit allowed when tax is payable by the fiduciary.—

LAW. Section 365. . . .

(3) In such cases, the estate or trust shall be allowed the same exemptions as are allowed to single persons under section three hundred and sixty-two, and in such cases an estate or trust created by a person not a resident and an estate of a person not a resident shall be subject to tax only to the extent to which individuals other than residents are liable under section three hundred and fifty-nine, subdivision three. . . .

It should be remembered that at the termination of the period of administration a return is to be made by the fiduci-

ary, and that in this return an exemption of \$1,000 is taken, however short the period of administration.¹⁴

Deductions allowed to fiduciaries.—

CHARITABLE CONTRIBUTIONS.—

LAW. Section 365.

2. The net income of an estate or trust shall be computed in the same manner and on the same basis as provided in this article for individual taxpayers, except that there shall also be allowed as a deduction any part of the gross income which pursuant to the terms of the will or deed creating the trust, is during the taxable year paid to or permanently set aside for the United States, any state, territory, or any political subdivision thereof, or the District of Columbia, or any corporation or association organized and operated exclusively for religious, charitable, scientific or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private stockholder or individual;

REGULATION. The net income of an estate or trust shall be computed in the same manner and on the same basis as the net income of an individual, except that there shall also be allowed as a deduction from the gross income any part of it which during the taxable year is, pursuant to the will or trust deed, paid to or permanently set aside for the United States, a State, a Territory or any political subdivision thereof, the District of Columbia, or any corporation or association organized and operated exclusively for religious, charitable, scientific or educational purposes or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private stockholder or individual (Art. 251.)

This regulation extends the right to deduct contributions so that the 15 per cent limitation will not apply to fiduciaries. Although the wording is somewhat different, the principles are the same as those laid down in federal article 341.

DEDUCTION FOR EXPENSES.—

REGULATION. Distinction is made between (1) expenses which are charges against the corpus of an estate or trust and (2) expenses which are incident to the business management of the estate or trust. Items falling under (1) are not proper deductions in computing net

¹⁴See article 246, page 348.

income, whereas items which fall under (2) are proper deductions in computing net income.

In accordance with the foregoing, executor's commissions, court costs and attorney's fees in connection with the settlement of an estate or the creation of a trust, which are directly chargeable to the corpus of the estate or trust, are not proper deductions in determining net income. Likewise, expenses incurred by a fiduciary in litigation to sustain a will are not proper deductions in determining net income. On the other hand, if the trustees' commissions are deducted from the income of the estate or trust distributable among the beneficiaries, the amount of such commissions should be entered as legitimate and necessary expenses properly deductible by the fiduciary for income tax purposes.

Expenses necessary to carrying on the business of the trust or estate by the fiduciary are deductible in the same manner as similar expenses of an individual; likewise interest, taxes, losses, depreciation and depletion are subject to the same rules relating to these deductible items as apply to individuals. (Art. 254.)

This article differentiates between expenses incident to carrying on the estate and those which are chargeable against the corpus. The former are deductible in computing net income, but the latter cannot be deducted.

DEDUCTION FOR PAYMENTS TO BENEFICIARIES DURING PERIOD OF ADMINISTRATION.—

LAW. Section 365. . . .

3. . . . except that in determining the net income of the estate of any deceased person during the period of administration or settlement there may be deducted the amount of any income properly paid or credited to any legatee, heir or other beneficiary. . . .

This section does not tax to the fiduciary distributions made to beneficiaries, as the tax on such payments is payable by the beneficiaries concerned.

DEDUCTION FOR DEPRECIATION.—Estates are entitled to the deductions for depreciation and obsolescence which would be allowed to individual taxpayers, unless the provisions of the will or trust require such depreciation to be deducted from the income distributable to beneficiaries.¹⁵

¹⁵Article 252, page 362.

RULING. Is it proper for a fiduciary to deduct any amount for depreciation prior to the distribution of income to beneficiaries?

Yes, estates are entitled to the same deductions as individuals and are subject to the same rules relating thereto. Such deduction, however, is not permissible to the beneficiaries unless the will or trust provides that the amounts of such depreciation are to be deducted from the income and added to the corpus of the estate, and such deduction must actually be made from the income paid to the beneficiaries and retained by the fiduciary or the same is not deductible to the beneficiaries. Unless the will or trust so provides for deduction from income, the beneficiary must report his entire distributive share. (Question 92, Comptroller's Questions and Answers, 1921.)

No taxable income on passage of property to fiduciary.—

REGULATION. No taxable income is realized from the passage of property to the executor or administrator on the death of the decedent, even though it may have appreciated in value since the decedent acquired it. In the event of delivery of property in kind to a legatee or distributee, no income is realized. Where, however, the executor sells property of the estate for more than its fair market value at the death of the decedent (or on January 1, 1919, if the decedent's death occurred prior thereto) the excess is taxable income. (Art. 251.)

Inheritance and estate taxes not allowable deductions.—

REGULATION. State inheritance taxes paid by the executor or administrator of an estate of a deceased person, which are provided by law to be deducted from the respective legacies or distributive shares, are not allowable deductions in computing the net income of such estate subject to tax, even though the will contains a direction to pay inheritance taxes out of the residue. An inheritance tax is upon the transfer of the property and not upon the estate of the decedent or upon the executor or administrator, although the latter is required to pay it. In general, taxes paid or accrued within the year imposed by the authority of any State, or otherwise, are limited to those imposed upon the taxpayer and do not include taxes paid by him on behalf of another, even though he is required by law to make such payment. Since, moreover, the tax is imposed upon the transfer before the property reaches the legatee or distributee, and merely diminishes the capital share of the estate received by him, such tax is not imposed upon the legatee or distributee and is not an allowable deduction from his income. Similarly, Federal estate taxes are not deductible. (Art. 144.)

Statutory allowance paid widow not deductible.—

REGULATION. . . . A statutory allowance paid a widow out of the corpus of the estate is not deductible from gross income. . . . (Art. 244.)

Withholding by fiduciaries not required.—

RULING. Is deducting and withholding required by resident trusts or resident estates which pay sums to nonresident beneficiaries?

No. Deducting and withholding is only required in respect of personal service compensation. (Question 101, Comptroller's Questions and Answers, 1921.)

Grantor taxable on income of revocable trust.—

REGULATION. . . . The gross income of a revocable trust must be included in the gross income of the grantor. . . . (Art. 251.)

Some of the peculiarities of revocable trusts are brought out in one of the Treasury's federal income tax bulletins¹⁶ as follows:

Where a declaration of trust provides that during the life of the donor he may indicate the manner in which the trustee shall exercise the powers conferred by the trust agreement; that the donor shall have a voice in determining the amount of net income to be distributed to the beneficiaries; and that the estate created and the interests vested thereunder shall be subject to revocation by the donor at any time, in whole or in part, it is held that the amount of income received by the beneficiaries is in the nature of a gift, and that the trustee merely acts as agent for the donor. The income of the trust should therefore be included in the gross income of the donor. . . .

The theory underlying the regulation is that the net income is a gift to the beneficiaries and in consequence it must be taken up as income by the donor. If this provision were not in effect, wholesale evasion would be possible by the creation of revocable trusts.

The author has discussed elsewhere¹⁷ another phase of the subject, namely, when the trustee has title to and sole control over the property conveyed, subject only to the grantor's revo-

¹⁶Bulletin 40-20-1224, Solicitor's Law Opinion 676.

¹⁷*Income Tax Procedure*, 1921, page 1030.

cation. The author states there his opinion that in such cases the income up to the act of revocation cannot, even constructively, be considered income of the grantor. Cases of this kind will have to be decided by the courts as they arise.

Beneficiaries

All amounts, on which the fiduciary has not already paid tax,¹⁸ received by beneficiaries from estates must be included by them in their individual tax returns and tax must be paid accordingly.

From the viewpoint of taxability the beneficiary will be classed as a resident or non-resident, his actual residence being the determining factor. Apportionment¹⁹ of the income from the estate may be necessary when there is a non-resident beneficiary.

The beneficiary is required to report his "distributive share" of the estate whether actually received or not. This share is to be determined in accordance with the law and regulations and may exceed the amount of cash or other property which is actually distributed to him by the fiduciary.²⁰ Such a condition might arise from losses from the resale by the fiduciary of capital assets which are not deductible by the beneficiary from the income received.²¹

Income received by beneficiary included in gross income.—

LAW. Section 359. The term gross "income":

1. Includes . . . gains or profits or income derived through estates or trusts by the beneficiaries thereof, whether as distributed or as distributable shares. . . .

However, this must not be interpreted to include income on which tax has been paid by fiduciary.

REGULATION. . . . Where the tax has been paid on the net

¹⁸See article 246, page 348.

¹⁹See page 348 and Chapter XVIII.

²⁰Article 252, page 353.

²¹See page 362.

income of an estate or trust by the fiduciary, such income is free from tax when distributed to the beneficiaries. (Art. 255.)

It is therefore necessary that a beneficiary take steps to ascertain whether or not the fiduciary has paid tax on any part of the income distributed to him. The kinds of estates on the income of which the fiduciary has to pay tax as well as those on the income of which the beneficiary must pay the tax are described in article 246.²²

For the taxability of a distribution of income, part of which is itself non-taxable, see page 348.

REGULATION. In the case of estates and trusts falling within subdivisions d, e and f of article 242,²³ the fiduciary is required to make a return on Form 205 as prescribed in article 246. The fiduciary is not required to pay any tax, the income being taxable directly to the beneficiary or beneficiaries. . . . (Art. 245.)

What must be included and for what period is stated below:

REGULATION. . . . Each beneficiary must include in his return his distributive share whether distributed or not, of the net income of the estate or trust for the taxable year, or, if his net income for such taxable year is computed upon the basis of a period different from that upon the basis of which the net income of the estate or trust is computed, then his distributive share of the net income of the estate or trust for any accounting period of such estate or trust ending within the fiscal or calendar year upon the basis of which such beneficiary's net income is computed. . . . (Art. 245.)

This article repeats a part of section 365 (4) of the law which is therefore not quoted here.

Income of non-resident beneficiary.—

LAW. Section 365.

4. . . . the income of a beneficiary not a resident, derived through such estate or trust, shall be taxable only to the extent provided in section three hundred and fifty-nine, subdivision three, for individuals other than residents.

REGULATION. . . . For the purpose of the imposition and collection of taxes under this article the residence of the beneficiary

²²See page 347.

²³See page 341.

is controlling. A resident beneficiary is taxable on the income of an estate or trust regardless of whether such income is derived from sources within or without the State and without consideration as to whether or not the estate or trust is a resident or nonresident estate or trust. A nonresident beneficiary is taxable only on such part of his income from the estate or trust as arises from sources within the State of New York (exclusive of annuities, interest on bank deposits, interest on bonds, notes or other interest-bearing obligations or dividends from corporations, except to the extent to which the same shall be a part of income from any business, trade, profession or occupation carried on in this State subject to taxation). The regulations governing partnerships are generally applicable to such an estate or trust. (Art. 245.)

RULING. An outline is requested of what constitutes, generally, income of a nonresident beneficiary from New York State sources.

A nonresident beneficiary is taxable only on that part of the income from the estate or trust arising from sources within the state of New York, which is

(a) From property owned; or

(b) From a business carried on within the state by the estate or trust.

He is not taxable on that portion of the income from the estate or trust received by it from annuities, interest or dividends, except to the extent to which they are part of the income from a business carried on within the state by the estate or trust. (Question 76, Comptroller's Questions and Answers, 1921.)

Deductions allowed to beneficiary.—In general the beneficiary is entitled to the same deductions as any other individual. There are certain deductions which it might seem feasible for the beneficiary to claim but they are not permitted by the regulations.

Losses and depreciation—when deductible.—

REGULATION. The gain and loss on the sale of capital assets will be considered capital items affecting the corpus only and the items of depreciation and bad debts will not affect the amount to be distributed, there being no provision of the trust requiring this deduction from distributable income. In such a case the fiduciary must report on Form 205, and must show as the distributive share of the beneficiary the amount to which he is entitled. The beneficiary must account for the amount actually distributable to him as income, as provided in section 365.

In order that the beneficiary may have the benefit of the losses on sale of assets, depreciation, etc., two conditions must be met: (1) the will or trust must provide that the amounts of such losses are to be deducted from the income and added to the corpus to make good such loss and (2) such deduction must actually be made from income, retained by the fiduciary and added to the corpus. Failure of either condition makes the beneficiary liable to tax on the entire income.

If there has been no loss on the sale of capital assets, Form 205 should show the distributive share of the beneficiary, and the amount remaining in the hands of the fiduciary should be shown on Form 201. (Art. 252.)

The following rulings will illustrate this point.

RULINGS. In reply to your letter of December 10, you are advised that losses from the sale of capital assets by a fiduciary are not deductible by the beneficiary from income received by him.

From the examples given by you, if the fiduciary sustains a loss in capital assets, and there are two beneficiaries each receiving \$5,000 income, each beneficiary will be obliged to return the \$5,000 as income without deduction for losses in the corpus which are not made good out of income. (Official ruling, dated January 8, 1920.)

I have your letter of January 15th. In reply, to your first question, you are advised that where the trust is not taxed as an entity, and it has a net loss for the year, no one can deduct such loss. The trust is then in the same position as an individual with a net loss for the year.

In reply to your second question, I am of the opinion that the remainderman cannot claim as a deduction losses from the sale of capital assets by the trust at the time that he receives the corpus. In my opinion, the remainderman is in the same position of receiving a tax-free gift of a lesser amount than the valuation at the time the estate was created.

By the terms of Article 93 of the State Regulations, a remainderman will compute gain or loss on sale of this property from the value at the date of acquisition by him. (Official ruling, dated January 17, 1920.)

In reply to your first query, you are advised that in the case of an estate or trust the income of which is payable to the life tenant who is not interested in the capital of the estate, the trustee of which sells securities in 1919 at a loss, thereby reducing the corpus, which at the end of the life estate goes to the remainderman, the capital loss is not deductible by the beneficiary from his current income.

In reply to your second question, you are advised that the ruling would not be different if the beneficiary of the trust estate were also interested in the corpus upon the termination of the trust. (Official ruling, dated January 8, 1920.)

In reply you are advised as follows:

1. A beneficiary may not deduct from income received by him from the estate or trust any amount of loss sustained by a fiduciary in the sale of assets unless such loss is deducted from the income payable to the beneficiary.

2. If the assets of the estate or trust are sold or otherwise disposed of at a profit and the profit retained by the fiduciary and not distributed to the beneficiary, such profit is taxable to the estate or trust and the tax must be paid by the fiduciary.

3. Profits referred to in answer 2 are not to be returned by the beneficiary unless distributed to him. . . . (Official ruling, dated January 8, 1920.)

Taxability of exchanges to beneficiary.—

RULING. A father having a life estate in real property exchanges it for a life estate in a mortgage. What is the reportable income in this transfer?

The difference between the value of the life estate as of January 1, 1919, if acquired prior thereto, and the value of the life estate of the mortgage calculable as of the date of exchange. (Question 88, Comptroller's Questions and Answers, 1921.)

Profit on sale of intestate's real estate taxable to beneficiaries.—

REGULATION. As an intestate's real estate does not pass to his administrator, upon a sale by the heirs, whether before or after settlement of the estate, each heir is taxed individually on any profit derived. . . . (Art. 244.)

By inference, *losses* in similar circumstances would be deductible by beneficiaries.

CHAPTER XVIII

NON-RESIDENTS

The state law¹ imposes a tax, at the same rates as those paid by residents,² upon the income of non-residents of New York State, when their income is derived from:

1. Real or tangible personal property located within New York State.
2. Any business, trade, profession or occupation carried on within the state.
3. Services rendered within the state.

In the original law the personal specific exemption of \$1,000 or \$2,000 and the \$200 exemption for each dependent allowed to residents were not granted to non-residents. The United States Supreme Court,³ however, held that this discrimination rendered the law void so far as it attempted to impose an income tax on non-residents. The legislature promptly remedied this defect by amending the law so as to grant the exemptions to "any taxpayer."⁴

Summary of Differences Between State and Federal Procedure

Income taxable under federal law but exempt by state.—
The following items of income which are taxable or partly taxable under federal procedure are not taxable to non-residents under the state law:

1. Interest of any kind, including interest on obligations of the United States and on War Finance Corporation bonds.

¹Section 351.

²See page 89.

³*Travis v. The Yale & Towne Mfg. Co.*, 252 U. S. 60; decision quoted in Appendix B.

⁴See page 34.

2. Dividends of all kinds.
3. Profits from the sale, exchange or gift of securities.
4. Any income from a source outside of the state of New York.

Unless any of the foregoing, other than interest on obligations of the United States, forms part of income from a business carried on in New York, when such income will be subject to apportionment.

5. Pensions and annuities from any source.
6. Compensation of federal employees and receivers appointed by federal courts.
7. Compensation of persons in the federal military or naval forces during the period of the present war.
8. Income received by officers of religious denominations if used for charitable and similar purposes.
9. Undistributed profits of personal service corporations.
10. Income accrued between March 1, 1913, and January 1, 1919.

Income exempt under federal law but taxable by state.—

1. Profit on exchange of convertible bond for stock.
2. Profit from sale of certain vessels [section 23 (2) Merchant Marine Act, 1920].
3. Profit due to unrealized appreciation of gift in hands of donor.
4. Christmas presents received by employees.
5. Interest on obligations of states other than New York and political subdivisions thereof.
6. Dividends paid out of surplus accumulated prior to March 1, 1913.
7. Dividends paid by personal service corporations from earnings accumulated since January 1, 1918, and prior to the beginning of the taxable year.

Only if any of the foregoing classes of income arise from sources within the state or from a business carried on within the state.

8. Compensation of officers and employees of the state of New York and its political subdivisions.

Deductions allowed by federal but not allowed by state procedure.—Non-residents may not deduct:

1. Any expenses incurred in connection with income arising from sources without the state.
2. Losses arising from the sale, exchange or other disposition of securities.
3. Losses arising from real or tangible personal property not having a situs within the state.

Unless any of the foregoing arise from business carried on within the state of New York, when such deductions will be subject to apportionment.

4. State income taxes.
5. Losses accrued between March 1, 1913, and January 1, 1919.
6. Contributions made to corporations or organizations not organized under the laws of New York State.

Deductions not allowed by federal law but permitted by the state.—The following deductions will be allowed to non-residents only in so far as they arise from sources within the state or in connection with business carried on within the state:

1. Interest on indebtedness incurred or continued to purchase or carry certain tax-exempt securities.
2. Loss due to unrealized depreciation of gift in the hands of the donor.

Apportionment.—If a business is carried on both within and without the state by a non-resident individual or by a partnership or estate or trust with a non-resident member or beneficiary, then special schedules must be filled out apportioning the income to sources within and without the state. No such apportionment is required under federal practice.

Credit for taxes.—A non-resident is entitled to credit against his New York tax a proportion of the tax paid to the state or country of his residence which is imposed on income taxed by the state of New York.

Tax withheld at the source may also be credited against the tax due.

Under federal procedure the above tax credits can be deducted only from net income and not from the federal tax.

Residents of Massachusetts.—Withholding is not required when a certificate of residence is filed.

Returns will not be required when the credit for taxes, imposed on income arising from sources within the state of New York and paid to the state of Massachusetts, exceeds the tax on the same income payable to the state of New York.

Basis to be used in computing profit, etc.—The federal law requires the value at March 1, 1913, or later cost to be used in computing profit or loss on sales of capital assets, also in the calculation of depreciation and depletion. The state law uses the value at January 1, 1919, or later cost for both residents and non-residents.

Tax on Non-Residents

The tax imposed upon non-residents is the same as that imposed upon residents, i.e., an income tax at the same rates, but only on certain specific income from New York State, whereas a resident is taxed on his income from all sources, both within or without the state.

LAW. Section 351. . . . A like tax⁵ is hereby imposed and shall be levied, collected and paid annually, at the rates specified in this section, upon and with respect to the entire net income as herein defined, except as hereinafter provided, from all property owned and from every business, trade, profession or occupation carried on in this state by natural persons not residents of the state. Such tax shall first be levied, collected and paid in the year nineteen hundred and

⁵See page 89.

twenty upon and with respect to the taxable income for the calendar year nineteen hundred and nineteen, or for any taxable year ending during the year nineteen hundred and nineteen.

A new section⁶ was added to the law in 1920, reimposing on non-residents the income tax imposed by section 351. This was necessary because the law previously had been declared unconstitutional⁷ so far as non-residents were concerned, because there was discrimination against them in their not being granted the same personal exemptions as were granted to residents.

Definition of "non-resident."—The law does not specifically define the word "non-resident," and in the frequent references in the law to a non-resident such an individual is described as "a taxpayer other than a resident,"⁸ or as "a person not a resident."⁹ The law, however, does define a "resident" as follows:

LAW. Section 350. . . .

7. The word "resident" applies only to natural persons and includes for the purpose of determining liability to the tax imposed by this article upon or with reference to the income of any taxable year, commencing with the year nineteen hundred and nineteen, any person who shall, at any time during the last six months of the calendar year, be a resident of the state.¹⁰

If an individual does not come within the foregoing definition, he will be classed as a "non-resident."

The following definition of a non-resident is found in the regulations:

REGULATION. "Nonresident" means an individual whose residence is not within the State of New York. Any individual living in the State of New York who is not a mere transient is a resident of the

⁶Section 351-a.

⁷*Travis v. The Yale & Towne Mfg. Co.*, 252 U. S. 60; quoted in full in Appendix B.

⁸Section 367.

⁹Section 365, 3.

¹⁰[Former Procedure] Paragraph 7 formerly read in part:

"any person who shall, at any time on or after January first, and not later than March fifteenth of the next succeeding calendar year, be or become a resident of the state."

State of New York for purposes of the Income Tax. Whether he is a transient or not is determined by his intentions with regard to his stay. If he lives in the State of New York and has no definite intention to leave or reside elsewhere, he is a resident. The best evidence of his intention is afforded by the conduct, acts and declarations of the individual. The typical transient is one who stops for a short time in the course of a journey through the State of New York, sometimes performing labor, sometimes not, or one who enters such State intending only to stop long enough to carry out some purpose, object or plan not involving an extended stay. A mere floating intention, indefinite as to time, to return to another State or country, is not sufficient to constitute him a transient. (Art. 502.)

Right of state to tax non-residents.—The question as to the constitutional right of a state to impose a tax on the incomes of non-residents from sources within the state was decided by the United States Supreme Court.¹¹ Mr. Justice Pitney said:

DECISION. . . . And we deem it clear, upon principle as well as authority, that just as the State may impose general income taxes upon its own citizens and residents whose persons are subject to its control, it may, as a necessary consequence, levy a duty of like character, and not more onerous in its effect, upon incomes accruing to non-residents from their property or business within the State, or their occupations carried on therein; enforcing payment, so far as it can, by the exercise of a just control over persons and property within its borders. . . .

As to the limitation placed on deductions allowed to non-residents, restricting them to sources within the state, the court in the same case said:

DECISION. . . . Appellant contends that there is a denial to non-citizens of the privileges and immunities to which they are entitled, and also a denial of the equal protection of the laws, in that the Act permits residents to deduct from their gross income not only losses incurred within the State of Oklahoma but also those sustained outside of that State, while non-residents may deduct only those incurred within the State. The difference, however, is only such as arises naturally from the extent of the jurisdiction of the State in the two classes of cases, and cannot be regarded as an unfriendly

¹¹*Shaffer v. Carter, State Auditor*, 252 U. S. 37; for text of decision, see Appendix B.

or unreasonable discrimination. As to residents it may, and does, exert its taxing power over their income from all sources, whether within or without the State, and it accords to them a corresponding privilege of deducting their losses, wherever these accrue. As to non-residents, the jurisdiction extends only to their property owned within the State and their business, trade, or profession carried on therein, and the tax is only on such income as is derived from those sources. Hence there is no obligation to accord to them a deduction by reason of losses elsewhere incurred. . . .

Returns

Individuals.—Every non-resident individual (if single or head of a family)¹² having a net income for the taxable year of \$1,000 or more from sources within New York State must make a return.

If a non-resident individual is married and living with husband or wife no return need be made unless the aggregate net income from sources within the state exceeds \$2,000. In that case a separate return must be made by each unless husband and wife join in a single return.

The law¹³ does not specifically mention non-residents, but does say: "Every taxpayer . . . shall make under oath a return. . . ."

Article 523 states: "The return shall be on form 203 in all cases."¹⁴

If a non-resident conducts a business as a sole proprietor, and the business is carried on both within and without the state, the apportionment of the income to sources within and without the state is made in schedule G, form 203.¹⁵

Returns by agents.—

REGULATION. . . . The responsible representatives of taxpayers not resident within the State in connection with any sources of income which such taxpayers may have within the State of New York

¹²For definition of "head of family," see page 35.

¹³Section 367.

¹⁴For illustration of non-resident return, see Appendix B.

¹⁵See example in Appendix B.

shall make a return of such income, and shall pay any and all tax, imposed upon the income received by them in behalf of their taxpayer principals, in all cases. The agent of a nonresident is responsible for a correct return of all income accruing to his principal within the purview of the agency. The agency appointment will determine how completely the agent is substituted for the principal for tax purposes. . . . (Art. 523.)

Returns may not be required in certain cases.—Section 366 of the law deals principally with withholding, information and payment at the source, but the following portion of that section confers on the Comptroller power to relieve a non-resident in certain cases from making a return even though having income from sources within New York.

LAW. Section 366. 1. . . . If it appears that another state has passed a law taxing incomes in such manner as will result in its residents being entitled to credit under section three hundred and sixty-three hereof, sufficient to offset all taxes imposed by this article, the comptroller may, by regulation, relieve residents of such state from being required to make any return under this article. . . .

The Comptroller has exercised the power granted him by the foregoing section, as is made evident by the following ruling. Considerable annoyance and expense to non-resident taxpayers will be avoided if they are relieved from making returns whenever the credit for taxes exceeds the New York tax.

RULING. In the case of a Massachusetts partnership dealing in securities, carrying on business in Boston and New York City, with all of the members residents of Massachusetts, is any partnership return on Form 204 or individual nonresident return on Form 203 required?

No, if the member had no other income from New York State sources. While article 230 of the Regulations specifically requires the filing of a partnership return for any partnership carrying on business in this state, under the circumstances recited, there would be no taxable income derived by the members of this partnership from New York State sources. This is due to the reciprocal provisions of amended section 363 of the law.

Massachusetts has an income tax law which imposes no tax upon earnings of nonresidents from sources in that state. Income of the character earned by this partnership is taxable by the State

of Massachusetts and, therefore, the credit allowed to these partners on their income derived from New York State sources would be offset by the tax which these Massachusetts residents paid in their home state, as that state imposes a higher rate of taxation on income of this character than New York State. Therefore, since the filing of such a return would not disclose any taxable income, the Bureau has ruled that none would be required. (Question 93, Comptroller's Questions and Answers, 1921.)

But compare the following:

RULING. In view of the compliance of the Massachusetts income tax law with the reciprocal requirements of section 363 of the New York personal income tax law, would a resident of Massachusetts who derived income from rents on real property in New York state, in excess of his personal exemption, be required to file any return under the New York law?

Yes, because the Massachusetts statute does not tax residents of that state on income from real property and, therefore, the provisions of the reciprocal portions of the Massachusetts statute would not apply on income of this character. (Question 77, Comptroller's Questions and Answers, 1921.)

Partnership returns.—Partnerships are required to make information returns¹⁶ (form 204) showing the distributive shares of the members. If the partnership has a non-resident member and carries on business both within and without the state, it must also file form 204-A, filling in the schedules shown on the form for the purpose of apportioning the income to services within and without the state. The non-resident member includes in his individual return (form 203, item 20, page 2 of return) his distributive share of the partnership income allocated to New York. The apportionment is necessary because the law¹⁷ provides that a non-resident shall be taxed only on certain income "from sources within the state." See further, Chapter XVI.

Fiduciary returns.—If an estate or trust has a non-resident beneficiary and carries on business both within and without

¹⁶See page 337.

¹⁷Section 359, 3.

the state, the fiduciary filing an information return on form 205 must also file at the same time form 205-A, which provides for apportioning the income from sources within and without the state. The beneficiary includes in his individual return his distributive share of the income allocated to New York State.

Returns by non-resident alien enemies.—

RULING. Is income distributable to nonresidents who are alien enemies, and which is not received by them, but in possession of and under control of the United States Alien Enemy Property Custodian, taxable?

No. But if a change of relations occurs between this country and the country to which the alien enemy beneficiary pledges allegiance whereby any part of such income is actually received by such beneficiary, he would be required to pay a tax upon any taxable income received by him from this source. (Question 74, Comptroller's Questions and Answers, 1921.)

Time and place for filing returns.¹⁸—Returns should be filed with the Comptroller and the tax paid thereon on or before the fifteenth day of the fourth month following the close of the fiscal year. If reporting on a calendar year basis, returns should be made on or before April 15.

RULING. When are nonresident returns due for the calendar year 1920?

Between January 1st and April 15, 1921. The amendment requiring the returns for the year 1919 on or before June 30, did not affect returns for subsequent years. (Question 75, Comptroller's Questions and Answers, 1921.)

Allowance of deductions dependent upon non-resident's filing return.—

LAW. Section 367: A taxpayer other than a resident shall not be entitled to the deductions authorized by section three hundred and sixty unless he shall make under oath a complete return of his gross income both within and without the state.

Although the law prescribes a return of "gross income both within and without the state," the return forms require a

¹⁸See page 64.

statement of income only from sources within the state, except when it is necessary to make an apportionment of income on a percentage basis.

REGULATION. Unless a nonresident individual shall render a return of income as required in article 523¹⁹ the tax shall be collected on the basis of his gross income (not his net income) from sources within the State of New York. Where a nonresident has income from sources within the State of New York, and a return of income shall not be filed by him or on his behalf, the Comptroller will cause an estimate of the taxable income of such nonresident taxpayer to be made, such estimate to include the income of such nonresident from all sources within the State of New York concerning which he has information, and for such purpose may examine or cause to be examined the books, accounts and records of such taxpayer and he will then compute the tax of such nonresident taxpayer without allowance for deductions or credit and with penalties and interest. (Art. 481.)

Exempt Income

LAW. Section 359. The term "gross income:"

3. . . . shall not include annuities, interest on bank deposits, interest on bonds, notes or other interest-bearing obligations or dividends from corporations, except to the extent to which the same shall be a part of income from any business, trade, profession or occupation carried on in this state subject to taxation under this article.

The foregoing exemptions were granted to non-residents to encourage them to keep their funds and investments in New York State.

Pensions exempt.—

REGULATION. When received by a nonresident, a pension of any kind is not taxable income as it is an annuity and, therefore, exempt from taxation against a nonresident. (Art. 413.)

Nearly all pensions are taxable to residents.

Interest and dividends exempt.—

REGULATION. Except to the extent to which interest and dividend income shall be part of the taxable income from any business, trade,

¹⁹See page 370.

profession or occupation, carried on within the State of New York, a nonresident shall exclude interest and dividends from gross income. (Art. 419.)

Interest and dividends—when taxable.—In reply to an inquiry from a resident of Florida, the state held²⁰ that interest on a New York mortgage was tax-exempt to such non-resident and the interest collected by an agent of the non-resident was not subject to withholding. If a non-resident individual, partnership or estate carries on business and, in such business, securities are carried as business assets, the state taxes the income therefrom. Form 203, schedule A, contains the following classification:

- 24. Interest.
- 25. Dividends from stocks carried as business assets.....
- 26. Profit from the sale of stocks and bonds, not dealt in as a business, but carried as business assets.

Examples of the kinds of investment, the holding of which renders the income therefrom taxable, are given in the following:

RULING. A banker, broker or dealer in securities, is likely, as a part of his business to have securities on hand for the purpose of reserve, purchase and sale, or speculation, and when he receives dividends they are taxable. A partnership, having a nonresident member, may hold securities as partnership assets, crediting dividends as partnership profits. The nonresident partner would be taxable on his entire profits from the partnership. . . . (Attorney-General's Income Tax Letter No. 34, dated May 22, 1920.)

DIVIDENDS OF PERSONAL SERVICE CORPORATIONS EXEMPT.
—As stated below, the income from investments held as part of a business is taxable to a non-resident, but the state holds that the dividends received from personal service corporations do not arise from employment of the stock as a business asset.

RULING. I do not think that because the dividends of a personal service corporation are due in part to the efforts of a non-resident stockholder acting in New York, he should be regarded as owning his stock as a *part of a business* carried on in the State. His

²⁰Official ruling, January 13, 1920.

ownership of the stock is independent of any business he carries on. The business in New York—his efforts on behalf of the corporation—may be incidental to his ownership of the stock, but the ownership is not incidental to the business.

The corporation pays its tax under Article IX-a of the Tax Law, just as any other business corporation, and I think the stockholders should be treated like stockholders in any other business corporation. (Attorney-General's Income Tax Letter No. 34, dated May 22, 1920.)

Profits from sale of securities exempt.—Not only are the interest and dividends on securities held by non-residents exempt, but the law exempts also the profit from the sale of such securities.

REGULATION. Gains and profits of a nonresident from the sale, exchange or other disposition of stocks, bonds and other securities are not taxable and should not be included in gross income, except to the extent to which the same shall be a part of the income from a business carried on in the State of New York, even though the sale or other disposition thereof may have been made within the State of New York or consummated on an exchange located within such State. . . . (Art. 416.)

TRADING PROFITS OF NON-RESIDENT MEMBERS OF STOCK EXCHANGE HOUSE.—

RULING. In reply to your letter of April 17 you are advised that if a nonresident of the state who is a member of a stock exchange firm trades on his own personal account and not as a member of the firm, his profits do not constitute income subject to tax provided he does not conduct such trading operations in connection with any "business carried on" within the state as defined in the regulations. (Letter to Morris F. Frey, the Guaranty Trust Company, New York, N. Y., signed by I. Sack, Assistant Director, Income Tax Bureau, dated April 21, 1920.)

The foregoing is a very liberal interpretation of the law, as the trading operations of a member of a stock exchange would seem to be part of his business. Certainly it is more of a business than exists when a non-resident investor who has a business office in New York buys and sells securities.

Income from vessels exempt in certain cases.—

REGULATION. The tax does not apply to charter money or freight or passage payments, received by a nonresident owner or lessee in

regard to a vessel which is operated exclusively between ports of the State of New York and foreign ports, or ports of other states, if the person receiving the income maintains no regular agency in the State of New York and is not carrying on business in the State of New York. (Art. 454.)

Determination of Gross Income

The law²¹ taxes non-residents only on income from sources within New York, so that a definition of the term "sources within the state" becomes important.

Definition of "sources within the state."—

RULING. . . . Under Article 415 a business, trade, profession or occupation is regarded as carried on within the State when the taxpayer maintains an office, shop, store, warehouse, factory, agency, or other place, where his affairs are systematically and regularly carried on therein, and if no such place of business is maintained without the State, the business is regarded as carried on wholly within the State. Similarly when no such place of business is maintained within the State, the business is regarded as carried on wholly without the State. Where such places of business are maintained both within and without the State, the business carried on within and without the State is allocated on the basis of business done through the different offices (or places of business).

That this rule is one calculated to result in an equitable distribution in the majority of cases, and one which would be sustained as just by the Courts, I have no doubt. . . . (Attorney-General's Income Tax Letter No. 39, dated September 23, 1920.)

For further definition of "sources within the state," see page 378 and article 415, page 392.

Having determined that the income is from a source within the state, the rules relative to the character and taxability of the income for a resident are then applicable to a non-resident. These rules have been discussed in preceding chapters.

Income from personal services.—

REGULATION. The gross income of a nonresident (not engaged in the practice of a trade, profession or occupation on his own account, but employed and receiving compensation for his services) includes compensation for personal services only if, and to the extent that, the

²¹Section 359, 3.

services were rendered within the State of New York. Compensation for personal services rendered by a nonresident wholly without the State is excluded from gross income regardless of the fact that payment may be made from a point within the State or that the employer is a resident individual, partnership or corporation.²² (Art. 412.)

RULING. "Sources within the state" obviously includes rents for the use of property in the state, profits of commerce carried on in the state, and so forth. The only doubt seems to arise with respect to payments made by a resident of the state or a concern doing business here, for services rendered which are actually performed outside of the state but inure to the benefit of someone within it or are paid for in the state or by remittance therefrom.

It seems to me that the work done, rather than the person paying for it, should be regarded as the "source" of income. It would follow that payments, wherever and by whomever made, for services performed without the state are not taxable against nonresidents and payments wherever and by whomever made, for services performed within the state are taxable against nonresidents.

Where services are rendered partially within and partially without the state, the income therefrom should be divided *pro rata* into income from sources within and without the state. I think the Comptroller should make a rule fixing the methods of prorating. (Attorney-General's Income Tax Letter No. 2, dated May 29, 1919.)

In the city of New York services are rendered by the executive heads of numerous corporations whose activities cover many states. Each branch may charge to expense a proportionate part of such executive salaries. While all or most of the executive's time is spent at the New York office, his earnings in a large part are attributable to services rendered to portions of the organization outside New York State; nevertheless, so long as the executive spends part of the time in New York it is not discrimination to tax that part of his time on the basis of a resident.

For a method of apportionment when part of the actual work done is outside the state, see page 389.

Income from business.—A non-resident individual may conduct a business within the state. In such case the entire net

²²See *Income Tax Procedure*, 1921, page 985.

income from the business is taxable. If a non-resident individual carries on a business both within and without the state, the entire net income is ascertained and then apportioned,²³ so that only the amount deemed to have arisen from sources within the state may be taxed.

REGULATION. In the case of a nonresident (other than one who is employed by another as distinguished from doing business on his own account) gross income from a business, trade, profession or occupation is determined in the same manner as is the gross income of a resident, from a business, trade, profession or occupation, but includes only income from a business, trade, profession or occupation carried on within the State of New York. (Art. 414.)

When a partnership with a non-resident member, or an estate or trust with a non-resident beneficiary, carries on a business both within and without the state, the net income from the business is first ascertained and then apportioned. Special forms (204A and 205A) are provided for partnerships and estates respectively.

Income from isolated sales.—Taxable income accrues to a non-resident from only two classes of sales, other than from a trade or business, viz.: (1) sales of real property located in New York State; (2) sales of personal property located in New York State, but not including stocks, bonds, or other securities²⁴ unless such securities are used in carrying on a business.

REGULATION. Gross income of a nonresident shall include all the profits derived from the sale, exchange or other disposition of real property located within the State of New York. It also includes all the profits derived from the sale, exchange or other disposition of personal property (other than stocks, bonds or other securities) having an actual situs within the State but not forming part of the assets of a business carried on within the State. Gross income from the sale, exchange or other disposition of real or personal property is determined in the same manner as gross income from similar sales by a resident. (Art. 417.)

²³For method of apportionment, see page 391 *et seq.*

²⁴For non-deductible losses from sales of securities, see page 385.

Income from rents and royalties.—If the property from which the rent or royalty is received is located within New York State, income from rents and royalties is taxable to a non-resident. If the property is located without New York State, the rent or royalty therefrom is not taxable.

REGULATION. The gross income of a nonresident from rents and royalties includes all rents and royalties received from property located within the State of New York and excludes all other rents and royalties. Such gross income is determined in the same manner as is the gross income of a resident from rents and royalties. Rent received by a nonresident for property located without the State is excluded from gross income regardless of the fact that payments may be made from a point within the State by a resident individual, partnership or corporation. (Art. 418.)

The following ruling declares that royalties from plays or moving picture rights received by a non-resident are not taxable. Royalties received by authors from the sale of books are in the same category. It appears, therefore, that the only royalties taxable to a non-resident are those received from mining properties. The test would appear to be that the property from which the royalties are received has its situs in New York State, and title thereto vests in the recipient of the royalties. In the case of intangible property the situs follows the owner. The production of the motion picture is not the business of the recipient of the royalties.

RULING. In reply to your letter of December 19, wherein you inquire as to the taxability of royalties received by an English author on plays produced by a New York manager in New York State and other States of the United States, you are advised that nonresidents are taxed under the New York State law only on income from (a) Property located within the State of New York; (b) Business, trade, profession or occupation carried on within the State of New York and that the income from royalties does not come within either of these classes and therefore is not subject to tax to nonresidents under the New York State law.

This applies also to royalties from the sale of moving picture rights regardless of the fact that the purchaser of the rights has his main office in New York City and permits the use of the motion picture both within the State of New York and elsewhere.

In reply to your third query, you are advised that the outright

sale by a nonresident author of motion picture rights of a play produced and written by him in England does not result in income taxable to a nonresident under the New York State law regardless of the fact that the sale was made in New York State. (Official ruling, dated Dec. 24, 1919.)

Income on which tax is withheld must be included.—

LAW. Section 366.

4. Income upon which any tax is required to be withheld at the source under this section shall be included in the return of the recipient of such income.

If a single person (a non-resident) received a salary of \$3,000 per annum for services performed in New York State, there would have been withheld by the employer \$20 (1 per cent on \$3,000, less the personal exemption of \$1,000). The employee in reporting to New York State, however, would return the gross amount, \$3,000, not the \$2,980 actually received. Item 19 (c), form 203, page 2 of return, provides for reporting the amount of tax withheld opposite the amount of income from personal services. The taxpayer would of course deduct from his total tax the \$20 paid on his behalf by the employer.

Deductions

The law imposes two conditions precedent to the allowance of deductions to non-residents: (1) a complete return of gross income from sources both within and without the state, must be filed;²⁵ (2) the deductions claimed must be "connected with income arising from sources within the state."

LAW. Section 360.

II. In the case of a taxpayer other than a resident of the state the deductions allowed in this section shall be allowed only if, and to the extent that, they are connected with income arising from sources within the state;

The general rules governing the allowance to a non-resident of the same deductions which are permitted to a resident are stated in the following:

²⁵Section 367.

REGULATION. In general the deductions from gross income allowable to a nonresident are the same as allowed to a resident, except that they are allowed only if, and to the extent that, they are connected with income arising from sources within the State of New York, that is, in connection with property owned or with a business, trade, profession or occupation carried on within the State. A nonresident taxpayer shall not be entitled to any deductions unless his return discloses his total gross income from sources both within and without the State to the extent required by the form of return. (Art. 431.)

A *complete* return of gross income from within and without the state is not required. Only such information as is called for by the return form is necessary.

Business expenses.—If a non-resident conducts a business entirely within the state of New York, he is taxed on the net income from such business, as a resident would be taxed. It follows, of course, that in computing the net income from the business he is allowed the same deductions as a resident. When the business is carried on both within and without the state an apportionment is necessary.²⁶

Deduction for interest.—The arbitrary limitation in the law as originally enacted on the deduction for interest has now been removed.²⁷ Section 360, paragraph 2 (as amended by chapter 693, laws of 1920), now permits the deduction of "all interest paid or accrued during the taxable year on indebtedness," but this is limited in the case of non-residents by the following:

REGULATION. A nonresident is entitled to deduct from gross income all interest paid or accrued during the taxable year in connection with taxable income from sources within the State of New York. (Art. 434.)

²⁶See page 391.

²⁷[Former Procedure] That part of section 360, 2, applying to non-residents read:

" . . . or in case of an individual not a resident of the state, the same proportion of interest paid or accrued within the taxable year on indebtedness which the amount of such gross income, as herein defined, bears to the gross amount of his income from all sources within and without the state."

The amendment is retroactive to January 1, 1920; hence does not affect 1919 returns.

A non-resident owning business property in New York State (even though for the time being it is not producing income) is entitled to deduct interest on loans to carry the property. On the other hand, interest on a loan covering a non-resident's private residence in New York has been disallowed.

RULING. Would a non-resident be allowed to deduct interest on indebtedness incurred in connection with a loan to build his private residence in New York City?

No, such indebtedness is not incurred in connection with any taxable income of the non-resident from sources in New York State, in the absence of any facts showing that the owner has any intention of renting his home. (Question 52, Comptroller's Questions and Answers, 1921.)

The foregoing appears to be quite as great a discrimination against non-residents as the former denial of the personal exemptions. In view of the right of a resident to deduct interest on a mortgage on his residence, the non-resident would seem to have the same right.

EFFECT OF AMENDMENT.—

RULING. In reply to your letter of June 16 with reference to the deduction of interest by a nonresident, we are of the opinion that the amendment to section 360 with regard to the deduction of interest does not affect nonresidents at all. Subdivision 11 of section 360 limits all deductions of nonresidents to the extent that they are connected with income arising from sources within the state. If, in connection with the earning of taxable income within the State of New York, a nonresident has to pay interest, such interest is deductible.

If a single interest bearing obligation applies to income from sources both within and without the State, the interest is deductible in the same proportion as determines the taxability of the income. (Letter to Morris F. Frey, the Guaranty Trust Company, New York, N. Y., signed by I. Sack, Assistant Director, Chief, Audit Division, and dated June 24, 1920.)

The foregoing ruling is not correct in stating that "the amendment to section 360 with regard to the deduction of in-

terest does not affect non-residents at all." Before the law was amended the interest deduction of a non-resident was subject to two limitations: (1) the interest paid must have been connected with income from sources within the state; (2) such interest was deductible only in the proportion that the gross income from New York—not including exempt income—bore to total gross income from all sources, whether tax-exempt or not. The amendment does not affect the limitation laid down in (1) but entirely removes the limitation in (2).

Deduction for taxes.—The comments relative to discrimination against non-residents in the case of interest paid²⁸ are applicable in the case of taxes.

REGULATION. Income taxes and taxes and assessments for benefits of a kind tending to increase the value of the property assessed, paid or accrued within the taxable year, are not deductible. Estate and inheritance taxes are not deductible. All other taxes paid or accrued by a nonresident are deductible to the extent that they are connected with sources of income derived from property owned or a business, trade, profession or occupation carried on within the State. (Art. 433.)

Deductions for losses.—While section 360 (11) states that deductions for losses shall be allowed non-residents "only if, and to the extent that they are connected with income arising from sources within the state," paragraphs 5 and 6 in the same section of the law still more definitely state the limitations on deductions for losses. The losses deductible are of three types, viz.:

1. Losses incurred in trade or business.
2. Losses incurred in transactions entered into for profit.
3. Losses from casualty or theft.

As to the first type, the law reads:

²⁸See page 383.

LAW. Section 360. . . .

4. Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in trade or business. . . .

There is no specific limitation on this type of loss other than the provision of section 360 (11) that it must be connected with income from New York sources.

LAW. Section 360. . . .

5. Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit though not connected with the trade or business; but in the case of a taxpayer other than a resident of the state, only as to such transactions²⁹ in real property or in tangible personal property having actual situs within the state. . . .

It is noticeable that a very definite limitation is attached to the allowance of this type of loss. Under the state law, stocks, bonds and other securities are not considered "tangible personal property"; consequently any losses therefrom are not deductible. This is sound because the profits and income from such sources are not taxable. When, however, losses from such transactions are incurred in a business such as that of a dealer in securities, they are fully deductible.

REGULATION. . . . losses sustained from the sale, exchange or other disposition of stocks, bonds and other securities . . . are not deductible, except to the extent that they may be losses incurred in, because forming a part of, a business carried on within the State. (Art. 416.)

The third type of loss is also more definitely limited as to non-residents.

LAW. Section 360. . . .

6. Losses sustained during the taxable year of property not connected with the trade or business, (but, in the case of a taxpayer other than a resident, only of real property or tangible personal property having an actual situs within the state)³⁰ if arising from fires,

²⁹[Former Procedure] The words "in real property or in tangible personal property having an actual situs" were added by amendment in 1920 retroactive to January 1, 1920.

³⁰[Former Procedure] The part of the paragraph in parenthesis read: "(but, in the case of a taxpayer other than a resident, only of property within the state)." The amendment was made retroactive to January 1, 1920.

storms, shipwrecks, or other casualty or from theft, and not compensated for by insurance or otherwise. . . .

The following summary of these three kinds of losses given in the following regulations elaborates the limitations stated in the law, apparently to make certain that only those transactions may be considered wherein, had a profit resulted, such profit would have been taxable.

REGULATION. A nonresident taxpayer may deduct from gross income on account of losses sustained during the taxable year and not compensated for by insurance or otherwise, as follows:

(a) If incurred in a trade or business carried on within the State.
(b) If incurred in any transaction within the State entered into for profit though not connected with a trade or business, but only if and to the extent that they are connected with real property located within the State, or with tangible personal property having an actual situs within the State, of such character that the income flowing from, or by virtue of, the transaction, if a profit had been realized, would have been included in the gross income of a nonresident.

(c) If arising from fire, storm, shipwreck or other casualty or from theft, but only if and to the extent that they are connected with real property located within the State, or tangible personal property having an actual situs within the State, of such a character, that the income flowing from it, or by virtue of it, if any, would be included in the gross income of a nonresident. (Art. 435.)

Deductions for contributions.—As contrasted with a resident, a non-resident is allowed to deduct contributions or gifts to corporations or associations operated for “religious, charitable, scientific or educational purposes,” only if such institutions are organized under the laws of New York.

LAW. Section 360. . . .

10. . . . In the case of a taxpayer other than a resident of the state this deduction shall be allowed only as to contributions or gifts made to corporations or associations incorporated by or organized under the laws of this state or to the vocational rehabilitation fund. . . .

The deduction for contributions is being allowed by the state up to 15 per cent of the taxpayer’s income from sources within the state.

RULING. Replying to the inquiries in your letter of May 22 you are advised as follows:

1. A nonresident taxpayer is permitted to deduct contributions made to New York corporations which are charitable and educational, when his only taxable income received in New York State is from a salary or rents of real property. Such contributions are permitted to an extent not exceeding 15% of the net income of such nonresident from New York State sources computed without the benefit of this deduction.

2. If such nonresident in paragraph No. 1 receives income from his individual business carried on in New York State such contributions are likewise deductible to the extent above stated.

It is assumed your uncertainty with respect to this statute arose by reason of the restrictive language in subdivision 11 of section 360 of the law which permits deductions to nonresidents only to the extent that they are made out of income arising from sources within this state. In preparation of the blank for nonresident returns consideration was given to the legislative intent in the use of this language. It is, therefore, the conclusion of this office that nonresidents who derive taxable income from sources within this State should be accorded the privileges of deductions against such income even though there is no direct connection between the source of the income and the fund from which the charitable contribution is made. It may safely be assumed that if the nonresident's income goes into a common fund that the charitable contribution which he makes in this State correspondingly reduces the taxable income which the nonresident receives from New York State sources. (Letter to Franklin Carter, Jr., signed by Comptroller Eugene M. Travis, by E. G. Zimmer, Assistant Director, Chief, Information Division, and dated June 3, 1920.)

The American Red Cross is a national organization, but the state permits the deduction by a non-resident of contributions made to a New York chapter. Contributions to the Y. M. C. A., if limited to relief or educational work, similarly are deductible.

Apportionment of Income to Sources Within the State

As a non-resident is taxable only on certain income from sources within the state,⁸¹ when the income attributable to

⁸¹Section 359, 3.

New York sources cannot be "earmarked" definitely it is necessary to make the allocation on some fair basis of apportionment.

The following summarizes the bases already announced by the state to be used in particular classes of cases:

Type of Earnings	Basis of Apportionment
Salaries and commissions—salesmen and agents.	Volume of sales.
Salaries and wages—corporate officers, clerks, laborers.	Time spent.
Professional practitioners.	Location of office.
Railroad trainmen—paid by mileage.	Mileage.
Seamen—within the port of New York operating between New York and New Jersey.	One-half.

Income from a business carried on within and without the state is ascertained in the same manner as for a resident. Assume the income to be \$20,000. The problem is to determine how much of this \$20,000 should be allocated to New York sources. The method prescribed by the Comptroller in article 457³² calls for the ascertainment of (1) New York State factors,³³ and (2) total factors. Assume that the ratio of (1) to (2) is 60 per cent. Then 60 per cent of the net income from the business (\$20,000), or \$12,000, is the amount allocated to New York.

The regulations³⁴ clearly state that all that is desired is "to allocate to the State of New York on a fair and equitable basis a proportion of such income," and if the method of using the factors suggested by the Comptroller does not work out equitably an alternative basis may be submitted.

Salaries and commissions of salesmen, agents, etc.—

REGULATION. The gross income from commissions and salaries earned by nonresident salesmen, drummers, agents or others, through

³²See page 393.

³³See page 393.

³⁴Article 470; see page 395.

whose services receipts or remuneration inure directly to the employer, for services performed or sales made within and without the State of New York, includes that proportion of the commissions and salaries received which the volume of business transacted by such employee within the State of New York bears to the total volume of business transacted by him within and without the State. Allowable deductions must be apportioned on the same basis. (Art. 451.)

If a salesman were receiving a much higher rate of commission, say, on sales to certain customers in New Jersey, than on sales to customers in New York, the basis outlined in the foregoing regulation would not be equitable, because while a much larger amount would actually be earned without the state, the apportionment on the basis of volume of sales would allocate an undue proportion to New York State. In such a case the salesman should definitely segregate sales within and sales without the state.

Salaries and wages—corporate officers, clerks, etc.—

REGULATION. If the nature of the employment of the nonresident is such that receipts of remuneration for services rendered do not inure directly to the employer, as in the case of corporate officers, clerical employees, laborers or other like classes of employees, gross income includes that proportion of the total amount received for services which the time employed within the State bears to the total time employed both within and without the State of New York. Allowable deductions must be apportioned on the same basis. (Art. 452.)

The foregoing ruling is sound, because the only part of the compensation taxed is the compensation for the time which is spent in New York. Even though the services are rendered to or for account of non-resident businesses the state may adopt a basis which restricts the tax to time employed in the state.

Earnings of professional men.—The test in the case of professional men is the location of the office. If one office only is maintained, and that in New York State, all the earnings are allocated to New York, although services may have been rendered without the state.

RULING. In the case of professional services rendered by lawyers, physicians, consulting engineers, architects, etc., rendered partly within and partly without the State, the test is the location of the office or recognized and established place of such occupation. If only one office is maintained, which office is located in the State, the entire income of such person is taxable notwithstanding the consummation of certain isolated transactions without the State. If, on the other hand, one or more offices are maintained without the State, the rule of allocating to the state a fair and equitable proportion of such income should be applied.

The principal office and place of business of the attorney in the case cited by you is located in New York City. He maintains no other office, although frequently performing services in other states.

I, therefore, conclude that the entire income derived by a non-resident attorney maintaining an office for the practice of his profession in the State of New York, and not elsewhere, is taxable under article 16 of the tax law. In such a case, it is not the place where the service is rendered which determines the taxability of the income, rather it is the place where the nonresident maintains an office or place of business from which he systematically and regularly carries on the practice of his profession, to which new business comes and from which it is executed.

This rule is applicable to all cases of nonresidents rendering professional services, who maintain offices for the practice of their professions in New York State and elsewhere. (Official ruling, dated May 25, 1920.)

In the case of professional practitioners maintaining offices within and without the state, but performing services for clients without the state through their New York office, the Attorney-General³⁵ has concurred in the view of the Comptroller that all income derived through the New York office must be considered as arising from sources within the state and that the location of the client's offices in which the services were performed is not a material factor.

Wages of railroad trainmen on mileage basis.—

RULING. Where such nonresidents are employed in train service, and the wages of such employees are based on mileage, the most practical way to fix a basis for determining the taxable income of such employees is to allocate the earnings in that proportion of the total

³⁵Attorney-General's Income Tax Letter No. 39, dated September 23, 1920.

amount received which the mileage within the State bears to the total mileage on which the wages are computed.

This rule of course may be followed only in the case of employees such as engineers, firemen, conductors, and brakemen employed on a regular run; one destination being in New York, the other outside of the State, and whose total compensation is based on mileage. (Official ruling, dated June 17, 1920.)

The above is the method adopted by the state in requiring withholding by railroad companies operating in New York and New Jersey, with paying offices in New York.

Wages of seamen.—

REGULATION. Resident seamen, like all other residents of the State of New York, are taxable on their entire net income as defined by the law and these regulations from whatever sources derived. Nonresident seamen, however, are taxable only on income derived from sources within the State of New York. The wage of a nonresident seaman earned on a vessel operating exclusively within the State of New York is regarded as income received from sources within the State of New York, and as such, is taxable income. The wage earned by a nonresident seaman on a ship which is operated exclusively between ports of the State of New York and foreign ports, or ports of other states is not to be regarded as from sources within the State of New York, even though at times the ship touches at a port within the State of New York and remains there a reasonable time for the transaction of its business. The presence within the State of a seaman aboard a ship which enters a port for the purpose of foreign or interstate trade is merely transitory and the wages earned during that period by a nonresident seaman are not taxable. Seamen employed on vessels operating between the States of New Jersey and New York within the port of New York are regarded as earning income from sources partly within and partly without the State of New York. One-half of the compensation earned aboard such a vessel by a nonresident is held to be taxable income. Withholding at the source applies with respect to all compensation of nonresident seamen, which in accordance with this article, constitutes taxable income. (Art. 453.)

Apportionment of Business Income

The apportionment of business income is required in three cases, when a business is carried on both within and without the state:

1. By a non-resident individual.
2. By a partnership with a non-resident member.
3. By an estate or trust with a non-resident beneficiary.

The first step is to determine whether or not the business is actually carried on both within and without the state.

Definition of "business carried on within the state."—

REGULATION. A business, trade, profession or occupation (as distinguished from personal service as employee) is carried on within the State by a nonresident when he occupies, has, maintains or operates desk room, an office, a shop, a store, a warehouse, a factory, an agency or other place where his affairs are systematically and regularly carried on notwithstanding the occasional consummation of isolated transactions without the State. Business is being carried on if it is here with a fair measure of permanency and continuity. Its regularity or continuity need not be for a long period; the life of the business is not a material factor. (Art. 415.)

The state holds that a business is being carried on wholly within the state.

REGULATION. . . . even though the nonresident or his representatives travel without the State for the purposes of the trade or business, that is for the purpose of buying, selling, financing or performing any duties in connection with the business, and even though sales may be made to, or services performed for, or on behalf of, persons or corporations located without the State. (Art. 455.)

Business carried on wholly without the state.—To decide whether a business is being carried on wholly without the state, it is necessary to compare the facts of the case with the provisions of the above-quoted articles 415 and 455 wherein is defined "business carried on wholly within the state." If the facts do not fit the latter definition, presumably the case must be one of "business carried on without the state."

REGULATION. No part of the net income of a nonresident from a business, trade, profession, or occupation, carried on without the State of New York (as "business carried on" is defined in article 415), and not carried on as so defined within this State, is taxable.

This is so, even though the nonresident or his representatives may enter the State for the purpose of buying, selling, financing, or per-

forming any other duty in connection with the business; and even though sales may be made to, or services performed for, or on behalf of, persons or corporations located within the State. (Art. 456.)

Apportionment of business income from business carried on both within and without the state.—

REGULATION. If a nonresident or a partnership with a nonresident member, carries on business (as "business carried on" is defined in article 415),⁸⁸ both within and without the State, the net business income therefrom must be apportioned so as to allocate to the State of New York a proportion of such income on a fair and equitable basis, in accordance with approved methods of accounting.

If the books of the taxpayer are so kept as regularly to disclose the proportion of his business income, which is earned from sources within the State, the return of the taxpayer shall disclose both the total income, and the part apportioned to the State of New York, and the basis upon which such apportionment is made. If such basis is approved by the Comptroller, the return will be accepted.

If the books of the taxpayer do not disclose the proportion of his net income from sources within the State of New York, his return, or if the basis of apportionment used by him shall not be approved by the Comptroller, his amended return shall disclose his net income from business both within and without the State, and the tax will be calculated and collected upon the portion of his total net income from business which the aggregate of the NEW YORK STATE FACTORS bears to the aggregate of the TOTAL FACTORS as herein defined.

The "NEW YORK STATE FACTORS" include the following:

(1) The average of the value of his real property and tangible personal property within the State, (a) at the beginning of the taxable year and (b) at the end of the taxable year, but only of property connected with the business.

(2) The total wages, salaries, and other personal service compensation paid during the taxable year to employees in connection with the business carried on (as defined in article 415) within the State.

(3) The gross sales or charges for services performed, by or through an agency (of the kind enumerated in article 415) located within the State. The sales or charges to be allocated to New York shall include all sales negotiated or consummated by salesmen, or services performed by other representatives, attached to or sent from offices, or other agencies, situated within the State of New York.

The "TOTAL FACTORS" include the following:

(1) The average of the value of all his real property and tangible

⁸⁸See page 392.

personal property (a) at the beginning of the taxable year, and (b) at the end of the taxable year, both within and without the State, but only of property connected with the business.

(2) The total wages, salaries, and other personal service compensation paid by him during the taxable year, to employees connected with the business, whether within or without the State.

(3) The gross sales, or charges for services performed, whether within or without the State.

"Business Income" as used in this article excludes profits (or losses) from the sale, exchange or other disposition of real property, and income from rents and royalties, income from these sources being taxable only if the property from which the income was derived was located within the State of New York, and in such case the entire net income from these sources is taxable.³⁷ (Art. 457.)

The illustration of a return of a non-resident shown in Appendix A indicates in schedule A, page 3 of return, form 203, item 30, net income of \$11,746 from a business carried on both within and without the state. The "factors" referred to in the above regulation may then be tabulated in schedule G, page 4 of the return, as follows:

1. Description of Items Used as Factors	2. Totals (Within and with- out the State)	3. New York State Amounts
(1) Value of the Real and Tangible Personal Property of the Business:		
(a) At the beginning of the period covered by the return	\$16,760.00	\$ 9,390.00
(b) At the end of the period covered by the return	14,720.00	7,580.00
TOTAL OF LINES 2 and 3.....	<u>\$31,480.00</u>	<u>\$16,970.00</u>
Average	\$15,740.00	\$ 8,485.00
(2) Wages, Salaries and Other Personal Service Compensation Paid During the Year	14,400.00	8,400.00
(3) Gross Sales of Merchandise, or Charges for Services, During the Year	240,000.00	150,000.00
TOTAL	<u><u>\$270,140.00</u></u>	<u><u>\$166,885.00</u></u>

The ratio of \$166,855 to \$270,140 is 61.777 per cent. This percentage applied to the total net income from the busi-

³⁷See page 367.

ness (\$11,746) gives \$7,256.33, the amount of net income from the business allocated to the state of New York. This amount (\$7,256.33) is then entered on page 2 of return, form 203, item 21, "income from business or profession."

If the apportionment is made for a partnership, form 204-A is used; if for an estate or trust, form 205-A. The same "factors," however, are used as shown in the above table.

Alternative basis of apportionment.—If the taxpayer feels that the foregoing methods do not correctly reflect the income arising from sources within the state⁸⁸ he is entitled to submit an apportionment which is more consonant with the facts and which will assign to the state the correct amount of income.

REGULATION. The provisions of articles 451 to 470 dealing with the apportionment of income of nonresidents earned from sources both within and without the State of New York are designed to allocate to the State of New York on a fair and equitable basis a proportion of such income earned from sources both within and without the State. Any nonresident may submit an alternative basis of apportionment with respect to his own income and explain that basis in full in his return. If approved by the Comptroller, that method will be accepted instead and in place of the one herein prescribed. (Art. 470.)

If an alternative basis of apportionment is submitted, the Comptroller in certain cases still requires that the computation called for by article 457⁸⁹ be also submitted, presumably for comparative purposes.

Both forms 204-A and 205-A contain the following instruction:

If, pursuant to article 470 an alternative basis of apportionment is submitted, or a partnership submits any basis of apportionment other than that described in article 457, the schedule contained on this form must be filled out and submitted in addition to all information and data used in the alternative method of apportionment.

⁸⁸Section 359, 3.

⁸⁹See page 393.

Exemptions and Credits

After the net income of a non-resident has been ascertained as outlined in the preceding pages, the amount of personal exemptions stated below is deducted from the net income and on the balance the tax is computed at the same rates as in the case of a resident.⁴⁰

Personal exemptions.—The law⁴¹ as it now stands (section 362) grants to a non-resident the same personal exemption and allowance for dependents which are permitted a resident. The law was amended as a result of the decision of the United States Supreme Court⁴² holding that failure to grant to non-residents the same personal exemptions as those allowed to residents was discriminatory and rendered the law unconstitutional so far as non-residents were concerned.

REGULATION. A nonresident is entitled to the same personal exemptions as are allowed to a resident taxpayer. (Art. 437.)

Credits for income taxes paid to other states.—To avoid double taxation of the same income the law provides for granting to a non-resident, against the tax computed under the New York law, credit of a corresponding part of the tax paid in the state of residence.

LAW. Section 363. Whenever a taxpayer other than a resident of the state has become liable to income tax to the state or country where he resides upon his net income for the taxable year, derived from sources within this state and subject to taxation under this article, the comptroller shall credit the amount of income tax payable by him under this article with such proportion of the tax so payable by him to the state or country where he resides as his income subject to taxation under this article bears to his entire income upon which the tax so payable to such other state or country was imposed; . . .

⁴⁰See page 89.

⁴¹[Former Procedure] Section 362, before amendment in 1920 read in part: "The following exemptions shall be allowed to any *resident* taxpayer." As amended, the section now reads "any taxpayer."

⁴²*Travis v. The Yale & Towne Mfg. Co.*, 252 U. S. 60; quoted in full in Appendix B.

"TAXES" DO NOT INCLUDE INTEREST OR PENALTIES.—

REGULATION. . . . Amount of "taxes payable" means taxes only (no credit being given for amounts representing interest or penalties) paid or accrued during the taxable year on behalf of the individual claiming credit. . . . (Art. 482.)

NON-RESIDENT ALIENS AND CITIZENS LIVING ABROAD.—

The credit for income taxes is not confined to those imposed by other states in the Union.

REGULATION. . . . "Other state or country" includes within its meaning territories, possessions, states and any foreign sovereignty. (Art. 482.)

Conditions precedent to allowance of credit.—

LAW. Section 363. . . . provided that such credit shall be allowed only if the laws of said state or country (1) grant a substantially similar credit to residents of this state⁴³ subject to income tax under such laws or (2) impose a tax upon the personal incomes of its residents derived from sources in this state and exempt from taxation the personal incomes of residents of this state. No credit shall be allowed against the amount of the tax on any income taxable under this article which is exempt from taxation under the laws of such other state or country. This section as amended shall apply to taxes for the year nineteen hundred and nineteen and each year thereafter.

Clause (2) of the foregoing represents an important amendment made in 1920 (effective for 1919 returns).

Before amendment, the law allowed to non-residents credit for taxes paid in another state or country, when such other state or country imposed a tax on income from sources therein received by residents of New York, and granted a substantially similar credit to residents of New York. This was deemed not to authorize a credit to residents of Massachusetts for tax paid in that state on income received from New York, because residents of New York were not subject to income tax in

⁴³[Former Procedure] This part of section 363 read:

" . . . provided that such credit shall be allowed only if the laws of said state or country grant a substantially similar credit to residents of this state subject to income tax under such laws."

Massachusetts. Thus, no credit was granted to residents of New York by the state of Massachusetts.

Clause (2) of the law, quoted above, meets the situation by granting the credit if the state in which the non-resident lives imposes a tax on income from New York sources and does not impose a tax on residents of New York.

The income received by the non-resident from New York, however, must be taxable in the state of the non-resident. Otherwise, obviously, no credit will be allowed against the New York tax on such income.

REGULATION. When credit is sought for income taxes paid to other States or countries pursuant to the Tax Law, section 363, the income tax return form of the individual must be carefully filled out with all the information called for therein, the calculation of credit indicated, and executed as provided therein. When the Comptroller receives proof that any other state or country allows a substantially similar credit, or imposes no tax upon and with respect to personal income of residents of this State within the meaning of section 363 of the Tax Law, that fact will be announced from time to time by amendment to this article.

Since the Commonwealth of Massachusetts in imposing an income tax, imposes no tax upon residents of this State with respect to personal income received from sources within Massachusetts, residents of Massachusetts are allowed the credit provided for in section 363 of the Tax Law against any tax due from such resident to the State of New York. (Art. 483.)

The return for non-residents, form 203, does not provide for crediting the amount of tax paid or accrued to the state where the non-resident resides. Credit may be taken, however, by writing in such amount as item 17, page 1 of the return, and deducting it from item 16, "total tax."

WHEN AMOUNTS SUBSEQUENTLY PAID DIFFER FROM ACCRUALS.—The following ruling is similar to the federal article⁴⁴ covering the procedure when the amount of "foreign" tax paid proves to be different from the accrual.

REGULATION. In case credit has been taken and allowed for taxes accrued, or a proportionate share thereof, and the amount that is actu-

⁴⁴Reg. 45, Art. 384.

ally paid on account of such taxes, or a proportionate share thereof, is not the same as the amount of such credit, or in case any tax payment credited is refunded in whole or in part, the taxpayer shall immediately notify the Comptroller. The Comptroller will thereupon redetermine the amount of the income tax of such taxpayer for the year or years for which such incorrect credit was granted. The amount of tax, if any, due upon such redetermination shall be paid by the taxpayer upon notice and demand by the Comptroller. The amount of tax, if any, shown by such redetermination to have been overpaid shall be immediately refunded to him. (Art. 484.)

Credit for tax withheld at source.—

LAW. Section 366. . . . any amount of tax . . . withheld shall be credited against the amount of income tax as computed in such return. . . .

Form 203, return for non-residents, is constructed so as to act automatically as a claim for refund if the amount of tax withheld exceeds the tax liability of the non-resident. Page 1 of the return contains the following instructions:

If Item 17⁴⁵ exceeds Item 16⁴⁶ on account of withholding at the source an amount in excess of Item 15⁴⁷ this return will be considered as a claim for refund. No other or further claim need be filed.

REGULATION. Where upon filing a return of income it appears that a nonresident taxpayer is not liable for tax, but nevertheless a tax shall have been withheld at the source, or where the amount withheld is in excess of his tax liability, in order to obtain a refund on the basis of the showing made by the return there shall be attached to it a statement showing accurately the amounts of tax withheld, with the names and post-office addresses of all withholding agents. (Art. 523.)

⁴⁵Tax withheld at source.

⁴⁶Total tax.

⁴⁷Total tax (same as item 16).

CHAPTER XIX

FARMERS

Although the ordinary principles of computing income for tax purposes which apply to individuals in general would, without alteration, be applicable to farmers, the Comptroller has prepared a special bulletin¹ giving concise information on the items of most importance to the farmer.

No special forms have been provided nor are any particular accounting methods specified. It is left to the judgment of the individual to decide what records he shall keep to enable him to discharge his statutory liability to file a return of his true income.

In this chapter only the regulations and rulings relating specifically to farmers are discussed. More detailed discussion is presented in the general chapters of this volume.

Difference between federal and state procedure.—A farmer who has prepared his federal return in accordance with the federal regulations is required to make one change for the state computation in addition to those items which are specifically mentioned in the chapters on exemptions, income and general deductions. Under both federal and state regulations a farmer is exempt from taxation on the value of the produce consumed by himself and household; but the state, unlike the federal law, does not permit the deduction of the expense or cost of producing what is so consumed. (See page 404.)

Definition of "farm."—

REGULATION. . . . As herein used the term "farm" embraces the farm in the ordinary accepted sense and includes stock, dairy, poultry, fruit and truck farms, also plantations, ranches and all land used for farming operations.

¹Official Bulletin No. 4, dated February 11, 1920.

Definition of "farmer."—

All taxpayers that cultivate, operate or manage farms for gain or profit, either as owners or tenants, are designated farmers. A person cultivating or operating a farm for recreation or pleasure, the result of which is a continual loss from year to year, is not regarded as a farmer. (Art. 30.)

The foregoing regulation is sound, but it may be misunderstood. A taxpayer may attempt in good faith to operate a farm at a profit, but may fail to realize a profit year after year, just as "dirt" farmers claim to be the case. He should call himself a farmer, but the mere fact that he admits that farming is a recreation or a pleasure should not preclude his classification as a farmer.

For a further discussion of the distinction between "gentlemen" farmers and "dirt" farmers see pages 405 and 409.

Computation of gross income.—In compiling his tax return a farmer, like other taxpayers, must include his entire income from all sources. For this reason income of any kind, whether received in cash or in kind, must be included.

RULING. A farmer's entire income from whatever source derived must be reported. Only income actually received need be included, but this does not mean that only cash income must be included. Anything of value received in lieu of cash is to be considered income to the extent of its fair market value. Thus, the value of groceries, merchandise, household services or supplies, etc., received in exchange for eggs, butter or other produce must be reported as income. (Official Bulletin No. 4, dated February 11, 1920.)

Generally a farmer will report on the basis of the calendar year, but if he has actually established a fiscal year which differs from the calendar year (e.g., as demonstrated by his books) he will report on the basis of his fiscal year.

Accounting bases of income computation.—A farmer may return his income on a receipt and disbursement basis, corresponding to the cash basis of other taxpayers, and include

therein all actual receipts, whether in cash or other commodities, and all actual disbursements permitted as deductions under the tax law. This basis is described in Official Bulletin No. 4 as follows:

If the inventories are not taken, the report must be made on the basis of actual receipts and disbursements, that is, report as gross income the amount received from the sale of farm produce, stock, etc., and deduct the ordinary items of expense actually paid during the year. If the report is made on this cash basis, there must not be included in expenses any payments for farm machinery or for live stock which were purchased for breeding, draft or dairy purposes. Payments for these items are regarded as investments and do not constitute deductible expenses. If, however, sales are made of live stock, machinery, or other item purchased, there must be reported the amount of profit, if any, received. The profit is the difference between the cost, less depreciation allowed and the sales price.

"Cost" in the above ruling means either the fair market value at January 1, 1919, or the price paid if the property was acquired subsequent to that date.

A more accurate basis of computation may be obtained from the use of inventories of farm products, supplies, live stock and machinery at the beginning and end of the taxable year. Such a method obviates all the difficulties of calculating profits or losses on sales of live stock, etc., which cannot be avoided on the cash basis. The official bulletin says:

It is desirable that farmers should take inventories of their purchased live stock, machinery and farm supplies on hand. However, it is recognized that many farmers do not take inventories and these instructions have been prepared for the guidance of farmers who take inventories as well as for those who do not take inventories.

Where inventories are taken, all live stock purchased whether for breeding, work or dairy purposes or for resale, and all machinery and purchased products on hand, should be entered at the cost price or market value, whichever is lower. In this way depreciation in value will be calculated. Live stock raised on the farm need not be entered on the inventory as the cost of feeding and raising it has been included in expense and deducted or charged off.

In considering the following regulations, these two bases of computation should be kept in mind.

Items entering into gross income of farmers.—The following particular items which may arise in the business of farming require consideration.

SALE OR EXCHANGE OF FARM PRODUCTS.—

REGULATION. All gains, profits and income derived from the sale or exchange of farm products, whether produced on the farm or purchased and resold, shall be included in the return of income for the year in which the products were actually marketed and sold, unless an inventory is used. . . . Where farm produce is exchanged for merchandise, groceries, or mill products, the market value of the article or product received in exchange is to be returned as income. . . .

SALE OF MACHINERY OR PURCHASED LIVE STOCK.—

in the case of the sale of machinery, and of animals purchased as draft or work animals or solely for breeding purposes and not for resale, any excess over the cost² thereof reduced by all sums theretofore deducted for depreciation shall be included as gross income in preparing the taxpayer's return. . . . When live stock purchased is sold, its cost, is to be deducted from the sales price in ascertaining the amount of gain or profit to be returned for tax purposes. If, however, an inventory is used the cost price of the articles sold must not be taken as an additional deduction in the return of income, as such cost price will be reflected in the inventory. . . .

CROP SHARE RENTS.—

Rents received in crop shares shall be returned as of the year in which the crop shares are reduced to money or a money equivalent. . . . (Art. 30.)

An exception is made if the crops are included in the inventory.

CROPS TAKING MORE THAN ONE YEAR TO PRODUCE.—

REGULATION. If a farmer is engaged in producing crops which take more than a year from the time of planting to the time of gathering and disposing, the income therefrom may be computed upon the crop basis; but in any such case the entire cost of producing the crop must be taken as a deduction in the year in which the gross income from the crop is realized. . . . (Art. 30.)

²See definition of cost, page 402.

The official bulletin states that in this case no income is to be returned until the crop is sold.

SALE OF LIVE STOCK RAISED ON THE FARM.—

RULING. In the case of stock raised on the farm and on hand January 1, 1919, the amount to be reported as income is the difference between the sales price and its fair market value on January 1, 1919. Where stock is sold which is raised on the farm subsequent to January 1, 1919, the entire amount received from the sale is to be reported as income. (Official Bulletin No. 4, February 11, 1920.)

FARM PRODUCE CONSUMED.—Although theoretically a farmer should include as income farm produce consumed in his household, he is not required to do so; but he cannot claim as a deduction the cost of raising the produce so consumed.

RULING. The value of farm produce consumed by the farmer and his family need not be reported as income, nor can expenses incurred in raising the produce thus consumed be claimed as a deduction, so that if all expenses are deducted, the cost (or a reasonable estimate thereof) of farm produce consumed by the farmer and his family must be included as income. (Official Bulletin No. 4, dated February 11, 1920.)

The federal regulations do not mention such a restriction on the deduction, but the principle is sound.

Deductions from income.—

EXPENSES OF FARMERS.—Expenditures on the farm can be segregated into:

1. Expenses deemed to be of a capital nature.
2. Current expenses.
3. Personal, living or family expenses.

Items falling within (1) and (3) are not deductible, but those in (2) are allowable deductions.

The regulations and the rulings in Official Bulletin No. 4, dated February 11, 1920, are very explicit as to the deductibility of the various classes of items and there should be little difficulty in following them.

. . .

REGULATION. A farmer who operates a farm for profit is entitled to deduct from gross income as necessary expenses all amounts actually expended in carrying on the business of farming. . . . (Art. 122.)

However, if the farm is *not* operated for profit, but for recreation or pleasure, the same article provides:

REGULATION. . . . If a farm is operated for recreation or pleasure and not on a commercial basis, and if the expenses incurred in connection with the farm are in excess of the receipts therefrom, the entire receipts from the sale of products may be ignored in rendering a return of income, and the expenses incurred, being regarded as personal expenses, will not constitute allowable deductions. . . . (Art. 122.)

See page 409 as to losses.

COST OF SMALL TOOLS.—

REGULATION. . . . The cost of ordinary tools, of short life or small cost, such as hand tools, including shovels, rakes, etc., may be included. . . . (Art. 122.)

Machinery, on the other hand, is a capital expenditure and as such is not deductible, but an allowance for depreciation is permissible.³

REGULATION. . . . The cost of farm machinery and farm buildings represents a capital investment and is not an allowable deduction as an item of expense. . . .

COST OF FEEDING LIVE STOCK.—

The cost of feeding and raising live stock may be treated as an expense deduction, in so far as such cost represents actual outlay, but not including the value of farm produce grown upon the farm or the labor of the taxpayer.

CROPS WHICH TAKE MORE THAN A YEAR TO PRODUCE.—

Where a farmer is engaged in producing crops which take more than a year from the time of planting to the process of gathering and disposal, expenses deducted may be determined upon the crop basis, and such deductions must be taken in the year in which the gross income from the crop has been realized. . . . (Art. 122.)

³See page 407.

It should be noted that the expenses of producing the whole crop must be deducted in one sum in the same year in which the proceeds of the crop are received and reported as income. If the expenses cannot be definitely ascertained, a reasonable estimate should be made, but the same items must not be deducted twice.

AUTOMOBILE UPKEEP, BUT NOT PURCHASE, PRICE DEDUCTIBLE.—

REGULATION. . . . The purchase price of an automobile even when wholly used in carrying on farming operations, is not deductible, but is regarded as an investment of capital. The cost of gasoline, repairs and upkeep⁴ of an automobile if used wholly in the business of farming is deductible as an expense; if used partly for business purposes and partly for the pleasure or convenience of the taxpayer or his family, such cost may be apportioned according to the extent of the use for purposes of business and pleasure or convenience, and only the proportion of such cost justly attributable to business purposes is deductible as a necessary expense. (Art. 122.)

LABOR—WHEN DEDUCTIBLE.—

RULING. Only that part of the board of hired labor which is purchased should be included as a deduction. The value of products furnished from the farm and used in the board of hired labor is not a deductible expense.

Rations purchased and furnished to laborers or share-croppers are deductible as a part of the labor expense.

The value of the farmer's own labor or that of his wife or dependent minor children cannot be deducted.

Do not deduct amounts paid to persons engaged in household work except to the extent that the services of such employees are used in the boarding and otherwise caring for farm laborers. Services of employees engaged in caring for the farmer's own household are not a deductible expense.

FERTILIZERS, MANURES, ETC.—

The cost of manures, commercial fertilizers, lime, raw rock phosphate, etc., that were paid for during the year may be deducted as an expense.

TAXES.—

All taxes, except income taxes, not including assessments for local

⁴An allowance for depreciation may be deducted.

improvements, are deductible. (Official Bulletin No. 4, dated February 11, 1920.)

CAPITAL ITEMS NOT DEDUCTIBLE.—Capital expenditures cannot be deducted, but an allowance for depreciation, based on the estimated useful life and salvage value, may be taken.

DEVELOPMENT OF FARMS, ETC.—

REGULATION. . . . Amounts expended in the development of farms, orchards and ranches prior to the time when the productive state is reached may be regarded as investments of capital.

PURCHASING LIVE STOCK.—

The amount expended in purchasing draft or work animals or live stock either for resale or for breeding purposes is regarded as an investment of capital. . . . (Art. 122.)

BUILDINGS.—

RULING. Amounts expended for the purchase or construction of buildings, fences, or in making good depreciation for which an allowance or deduction was made, are not deductible. (Official Bulletin No. 4, dated February 11, 1920.)

DEDUCTION FOR DEPRECIATION.—The general principles governing deduction for depreciation in the case of other individual taxpayers apply to farmers.

REGULATION. A reasonable allowance for depreciation may be claimed on farm buildings (other than a dwelling occupied by the owner), farm machinery and other physical property including live stock purchased for draft, dairy or breeding purposes, but no claim for depreciation on live stock raised, or purchased for resale, will be allowed. Live stock purchased for draft, breeding or dairy purposes, or for any purpose other than resale, may be included in the inventory for each year at a figure which will reflect the reduction in value estimated to have occurred during the year through increase of age or other causes. Such a reduction in value should be based on the cost and estimated life of the live stock. If an inventory is not used, a reasonable allowance for depreciation may be claimed based upon the cost of draft and work animals and animals kept solely for breeding purposes and not for resale. (Art. 181.)

It should be noted that no depreciation may be claimed on farm buildings occupied by the owner as a dwelling.

DEDUCTIONS FOR LOSSES.—The losses which may be deducted are described in the following article.

REGULATION. Losses incurred in the operation of farms as business enterprises are deductible from gross income. If farm products are held for favorable markets, no deduction on account of shrinkage in weight or physical value or by reason of deterioration in storage shall be allowed. The total loss by frost, storm, flood or fire of a prospective crop, or of a crop which has not been sold, is not a deductible loss in computing net income. A farmer engaged in raising and selling stock, cattle, sheep, horses, etc., is not entitled to claim as a loss the value of animals that perish from among those animals that were raised on the farm. If live stock has been purchased for any purpose, and afterward dies from disease, exposure or injury, or is killed by order of the authorities of a State or the United States, the actual purchase price of such stock, less any depreciation which may have been previously claimed with respect to such perished live stock, and less also any insurance or indemnity recovered, may be deducted as a loss. The actual cost of other property, less depreciation already allowed, destroyed by order of the authorities of a State, or of the United States, may in like manner be claimed as a loss; but if reimbursement is made by a State or the United States in whole or in part on account of stock killed or property destroyed, the amount received shall be reported as income for the year in which reimbursement is made. In determining the cost of stock for the purpose of ascertaining the deductible loss there shall be taken into account only the purchase price, and not the cost of any feed, pasturage or care which has been deducted as an expense of operation. If gross income is ascertained by inventories, no deduction can be made for live stock or products lost during the year, whether purchased for resale or produced on the farm, as such losses will be reflected in the inventory by reducing the amount of live stock or products on hand at the close of the year. If an individual owns and operates a farm, in addition to being engaged in another trade, business or calling, and sustains a loss from such operation of the farm, then the amount of loss sustained may be deducted from gross income received from all sources, provided the farm is not operated for recreation or pleasure. (Art. 155.)

It will be seen that in the case of loss the cost of the item involved, less reasonable depreciation, may be deducted if the cash basis is used for returning income, but that, if the inventory method is used, the inventories themselves will reflect the loss. When the latter method is used, the provision in the

second sentence of the regulation relative to shrinkage due to storage for a more favorable market is not applicable.

LOSSES OF "GENTLEMEN" FARMERS.—The federal and state regulations hold that farms must be operated as business enterprises in order that net losses incurred may be deducted from income derived from other sources. The federal regulations defining the term "trade or business" have been unduly restrictive and in the opinion of the author the courts will define the term more broadly.⁵

In a recent decision in a United States district court it was held that a capitalist who owned several farms was entitled to deduct the net loss arising from the operations of those upon which he did not live, but that the farm which included his residence could not be deemed to be a business enterprise.⁶ The federal Commissioner of Internal Revenue had disallowed all the deductions.

LOSSES FROM BAD DEBTS.—

RULING. Deduct only debts which are ascertained to be worthless within the year for which you are reporting. If you are reporting purely on a cash basis, bad debts arising from the sale of farm produce can not be deducted. If, however, all sales made by you whether on cash or credit are included, debts which are ascertained to be worthless may be deducted, provided the original sale was included in income. Whichever basis is used, bad debts arising from the sale of machinery and any other capital asset may be deducted.

The form to be used.—

It will be necessary for resident farmers to use Form 201. That is the form which contains the business schedule, (See Item 25). A non-resident farmer should use Form 203. These instructions apply alike to resident and non-resident farmers, (Official Bulletin No. 4, dated February 11, 1920.)

⁵See *Income Tax Procedure*, 1921, page 819.

⁶*Fish v. Irwin Collector* (U. S. District Court for the 3rd District of N. Y., February 16, 1921).

PART II

FRANCHISE TAX
ON CORPORATIONS

CHAPTER XX

SUBJECTS OF THE TAX

The New York state franchise tax on corporations is in form an excise tax imposed upon domestic (New York) corporations for the privilege of exercising their franchises within or without the state, and upon foreign (meaning any other than New York) corporations for the privilege of doing business within the state of New York. In practice the tax is an income tax, excepting in those cases when corporations have very small net incomes or none at all. In such cases either a tax based on capital stock or a minimum tax of \$10 is imposed.

The franchise tax law was enacted June 4, 1917, but has been the subject of amendments each year since that time. The original law applied only to manufacturing and mercantile corporations and levied a tax at the rate of 3 per cent. The 1919 amendments increased the rate of tax to 4½ per cent and enlarged the scope to include all business and financial corporations (with certain exceptions). The 1920 amendments (chapter 640, Laws 1920, effective May 10, 1920) introduced more definite provisions regarding the segregation of assets within and without the state, the requirement of consolidated returns, the basing of the tax on foreign corporations doing business within the state on entire net income, and not on that reported to the federal government, and a provision allowing the Comptroller to modify interest penalties.

The law has been narrowly and arbitrarily administered, and taxpayers have found it difficult to secure rulings and interpretations on doubtful points of procedure. In this respect the administration of the personal income tax law by the Comptroller's office compares most favorably with the administration of the franchise tax law.

Imposition of Tax

LAW. Section 209. For the privilege of exercising its franchise in this state in a corporate or organized capacity every domestic corporation, and for the privilege of doing business in this state, every foreign corporation, except corporations specified in the next section, shall pay an annual franchise tax, ...

The tax is imposed for the privilege of doing business on both domestic and foreign corporations (with certain exceptions). Quite independent of the basis on which the tax is levied, the tax paid by corporations is their contribution to the state for being permitted to carry on business within the state and for receiving the protection of the state courts and such other protection as may lawfully be demanded.

“Corporation” defined.—

LAW. Section 208. . . . The term “corporation” includes a joint-stock company or association;

While this definition, if it can be called such, is very similar to that used in the 1918 federal income tax law, it must not be assumed that the state tax department has blindly followed general rulings as to what associations, etc., come within the category of corporations. Thus, Massachusetts trusts have been held by the state to be liable to the franchise tax, whereas the federal law does not consider them as “associations.”¹

MASSACHUSETTS TRUSTS AND PENNSYLVANIA JOINT-STOCK ASSOCIATIONS TAXABLE.—

RULING. Replying to your letter with respect to the liability of a Massachusetts common law trust doing business in this state, permit me to say:

It is clear and conclusive that such an organization, or any combination of individuals, which proceeds to do business in this state under rules or regulations of business which are equivalent to a compliance with the enabling provisions of our statutes, and assumes an independent personality and the privileges not possessed

¹Federal Treasury Bulletin Digest 10-19-351; Solicitor's Opinion 1068, quoted in *Income Tax Procedure*, 1921, page 106.

by individuals, is within the scope and purposes of Articles 9 and 9-a of the tax law, and has been since the enactment of chapter 542 of the laws of 1880 and chapter 726 of the laws of 1917, respectively.

The department is now proceeding against delinquents of this character.

This ruling covers Pennsylvania Joint Stock Associations. (Letter dated March 2, 1920, signed by Commissioner John J. Merrill.)

Fortunately for taxpayers, the finding of a Tax Commissioner that a point of law is "clear and conclusive," when in fact it is a very difficult question, merely means that the Commissioner thinks so at the moment. Many limited partnerships are not corporations and cannot be taxed as such.

Taxation of foreign corporations.—Foreign corporations are taxed "for the privilege of doing business in this state"² on the same basis as that on which a domestic corporation is taxed for the privilege of exercising its franchise. No tax is levied directly on the personal property of foreign corporations, a procedure which would be unconstitutional, but such corporations are treated "as if they were residents of the state."³

By the action of section 214 the tax will in effect be based on the business which is done by the foreign corporation within the state, its real and tangible personal property within the state and the proportion of stocks held by it allocated to the state. Although in an individual case this basis may not be a mathematically correct one, yet as a whole it taxes foreign corporations only on their activities in the state of New York.

Domestic and foreign corporations.—There is no section in the law defining domestic or foreign corporations or differentiating between them. For this reason it may be presumed that these words are to be interpreted in their usual significance as to a particular state: domestic corporations being those created or organized under the laws of the state; any other

²Section 209, page 414.

³See statement of Tax Commissioner, November 19, 1919, quoted in *Income Tax Procedure*, 1920, page 1006.

corporations being foreign. A corporation receiving a New York charter with the intention of doing business in the state would be a domestic corporation; but a New Jersey corporation or a French company doing business here would be classed as foreign.

This distinction between domestic and foreign corporations is stated in the general corporation law, section 3-5:

A "domestic corporation" is a corporation incorporated by or under the laws of the state or colony of New York. Every corporation which is not a domestic corporation is a foreign corporation, except as provided by the code of civil procedure for the purpose of construing such code.

Personal service corporations subject to the tax.—So-called personal service corporations are subject to the tax precisely as other corporations. The term "personal service corporation" appears only in the federal income tax law and in no way interferes with or modifies corporate entities as created by state authority. Personal service corporations report on line 8 of form 3 IT, their entire net income returned under schedule A, item 26, of federal form 1065.

RULING. A corporation not dealing in tangible personal property, or one engaged wholly or partially in rendering services for profit, should report under Article 9-A of the tax law, showing in answer to item (8) the amount of its entire net income for its fiscal or calendar year. (Letter to the Corporation Trust Company, signed by Deputy Commissioner N. W. Canfield.)

Corporations taxable under article 9-a of the tax law not subject to tax under article 9.—

RULING. Replying to your inquiry as to whether or not corporations are liable to franchise taxes under both Articles 9 and 9-a, permit us to say:

Taxes payable under both articles are for the same privilege, i.e., for the privilege of exercising a corporate franchise in the case of a domestic corporation, and for the privilege of doing business in this state in the case of a foreign corporation.

There is no evident intention in the two articles to impose two taxes for the same privilege. Wherever two ways of measuring the value of a privilege have been used, as in Sec. 182 and Sec. 184

of the tax law, there has been no question of the intent. The words "additional franchise tax" have been used in the heading for Sec. 184. Undoubtedly if the legislature had intended the tax under Article 9-a to be an additional franchise tax it would clearly have indicated it, as it did in Sec. 184 of the tax law.

It is true that the rule against double taxation is a rule of the legislature and not of law, and that the courts have several times refused to interfere with double taxation, but they have always upheld that construction of a statute which will relieve the property or the privilege from double taxation whenever a statute is susceptible of such construction without forcing.

With this thought clearly in mind it is the conclusion of this department that corporations taxable under Article 9-a are not subject to the provisions of Article 9 since the taxes under each article are for the same privileges and the moneys collected are for the same purposes as those under the other, and no reason can be ascribed for any such intent upon the part of the legislature. To assume the opposite position would be inequitable, unjust and oppressive, and furthermore is uncalled for within the bounds of reason. (Letter to The Corporation Trust Company, dated August 2, 1920, signed by Commissioner John J. Merrill.)

Article 9 of the general tax law imposes a general property tax, including a tax on personal property owned by individuals and corporations. The personal income tax law relieves individuals from tax on their personal property in so far as such property consists of money, bonds, choses in action and shares of stock in corporations other than banks.⁴

Article 9-a is the franchise tax law discussed in this chapter, and it has been held that corporations subject thereto are no longer subject to the personal property tax law.⁵

Other tax exemptions of corporations subject to franchise tax.—

LAW. Section 219-j. After this article takes effect, corporations

⁴Income tax law, section 352.

⁵*State ex rel. Franklin Mill Co., Wiard Plow Co., Batavia Rubber Co., and Johnston Harvester Co. v. Collins et al* (holding that manufacturing corporations are exempt from tax on personal property for school purposes), 109 Misc. 1. Also see *People ex rel. United Shoe Machinery Co. v. Cantor* (holding that foreign as well as domestic corporations are exempt from personal property tax, if liable to tax under Art. 9-a), 112 Misc. 603. For text of foregoing decisions, see Appendix B.

taxable thereunder shall not be assessed on any personal property, or on capital stock as provided for in section twelve of this chapter.

The interpretation of this section of the law has been a subject of dispute. However, in a recent decision^a of Judge McAvoy it was held that it should be construed to exempt foreign corporations from the personal property tax under section 7 of the state laws.

PERSONAL PROPERTY DEFINED.—

LAW. Section 219-l. The term "personal property," for the purposes of the exemption from assessment and taxation thereon locally as granted by section two hundred and nineteen-j of this chapter, shall include any movable machinery and equipment used for trade or manufacture and not essential for the support of the building, structure or superstructure, and removable without material injury thereto. The term "personal property," as used in such section, shall not include boilers, ventilating apparatus, elevators, plumbing, heating, lighting and power generating apparatus, shafting other than counter-shafting, equipment for the distribution of heat, light, power, gases and liquids, nor any equipment consisting of structures or erections to the operation of which machinery is not essential. An owner of a building is entitled to the same exemption under this section as a lessee.

Corporations exempt from the tax.—Certain types of corporations are specifically exempt from the franchise tax levied by article 9-A.

LAW. Section 210. Corporations wholly engaged in the purchase and sale of, and holding title to, real estate for themselves, corporations whose sole business consists of holding the stocks of other corporations for the purpose of controlling the management and affairs of such other corporations, except such as are specifically subject to report under the provisions of subdivision nine of section two hundred and eleven of the tax law, and corporations liable to tax under sections one hundred and eighty-four to one hundred and eighty-nine inclusive of this chapter, banks, savings banks, institutions for savings, title guaranty, insurance or surety corporations shall be exempt from the payment of the taxes prescribed by this article.

^a*People ex rel. United Shoe Machinery Co. v. Cantor*, 112 Misc. 603; quoted in Appendix B.

The types of corporations mentioned above are:

1. Corporations wholly engaged in the purchase and sale of and holding title to real estate for themselves.
2. Corporations whose sole activity consists in holding stocks of other corporations for the purpose of controlling the management and affairs of other corporations (with certain exceptions—see section 211).
3. Steam surface railroad, canal, steamboat and other transportation corporations,⁷ which are subject to tax under section 184 of chapter 62 (Laws 1909).
4. Corporations owning or operating elevated railroads or surface railroads which are not operated by steam, waterworks companies, gas companies and electric or steam heating, lighting and power companies, which are subject to tax under sections 185 and 186.
5. Insurance companies, which are subject to tax under section 187.
6. Trust companies subject to tax under section 188.
7. Investment companies subject to tax under section 188-A.
8. Savings banks subject to tax under section 189, including banks, savings banks, institutions for savings, title guaranty, insurance or surety corporations.

REAL ESTATE CORPORATIONS.—Real estate corporations, to be exempt under this section, must be “wholly engaged in the purchase and sale of, or holding title to real estate for themselves.” Therefore, a real estate corporation engaged in the purchase and sale of, or holding title to real estate for others would not be exempt from the provisions of the law.

It is understood that the tax department is construing this section very literally and excluding any corporations which have the slightest outside interest.

⁷Except interborough ferry companies.

HOLDING CORPORATIONS.—Previous to amendment in 1920 the law exempted “holding companies whose principal income is derived from holding the stocks and bonds of other corporations”—a definition which was very vague. The state tax department had, however, issued a ruling⁸ which clarified the situation and interpreted the section in the same sense as that expressed in the amended section above.

Control of the management of other corporations is, briefly, the basic principle underlying holding corporations. It was never intended to class among holding companies corporations which bought and sold securities of other corporations, and the amendment has made this clear.

Section 211 (9) gives the Tax Commisisoner power to require consolidated returns of holding companies and subsidiaries, so as to view the group in its proper relationship to the taxing authority. This requirement is justified when all the affiliated corporations are doing business within the state, but, as the state can neither tax a foreign corporation not doing business within the state nor require a return from such a corporation, it is much too sweeping and should be amended so as to state correctly the obligations of taxpayers.

⁸Quoted in *Income Tax Procedure*, 1920, pages 1013, and 1014.

CHAPTER XXI

WHAT CONSTITUTES DOING BUSINESS

General

It is often difficult to determine whether or not the acts or transactions of a non-resident individual, foreign corporation or partnership within the boundaries of a state constitute "doing business" in such state. As the application of the tax laws, with which we are concerned, to non-residents and foreign corporations turns entirely upon whether or not they are "doing business" within the state, the meaning and construction, as used in the laws, become matters of very great importance.

The two expressions "doing business" and "carrying on business" mean practically the same thing, the former being used in the franchise tax law imposed on foreign corporations and the latter in the personal income tax law taxing the net income of non-resident individuals. The state laws affecting the rights of foreign corporations and of non-resident individuals may and do differ in many respects in determining what facts will bring either within the purview of the law. As to what constitutes "doing business" or "carrying on business" in the state, there is no significant difference. Hence the following discussion will be concerned in the main with corporations, and it can be understood that usually the same principles will apply to non-resident individuals. Distinctions will be drawn where it is thought necessary or advisable.

The expression "doing business" is not a new one and is not one peculiar to tax laws. But it has been used in various laws of states, regulating or controlling in some way the acts of foreign corporations. As a consequence of its frequent use and flexibility in meaning, the question of its construction has been before the courts many times. There are so many

conflicting decisions that it is sometimes hard to reconcile the various constructions and know just what inferences should be drawn or what conclusions should be reached.

Provisions of the law and regulations.—The pertinent section of the franchise tax reads as follows:

LAW. Section 209. **For the privilege of exercising its franchise in this state in a corporate or organized capacity every domestic corporation, and for the privilege of doing business in this state, every foreign corporation, except corporations specified in the next section, shall annually pay a franchise tax. . . .**

The personal income tax law provides that:

LAW. Section 351. . . . A like tax¹ is hereby imposed and shall be levied, collected and paid annually, at the rates specified in this section, upon and with respect to the entire net income as herein defined, except as hereinafter provided, from all property owned and from every business, trade, profession or occupation carried on in this state by natural persons not residents of the state.²

In this chapter only the construction to be given the expressions as they are used in the tax laws above quoted is important; consideration of their other uses is important only to the extent that it assists in attaining that end.

Business carried on within the state by a non-resident individual is defined in the Comptroller's regulations as follows:

REGULATION. A business, trade, profession or occupation (as distinguished from personal service as employee) is carried on within the State by a nonresident when he occupies, has, maintains, or operates desk room, an office, a shop, a store, a warehouse, a factory, an agency, or other place where his affairs are systematically and regularly carried on notwithstanding the occasional consummation of isolated transactions without the State. Business is being carried on if it is here with a fair measure of permanency and continuity. Its regularity or continuity need not be for a long period; the life of the business is not a material factor. (Art. 415.)

¹Similar to the tax on residents.

²This section was declared unconstitutional in *Travis v. Yale & Towne Mfg. Co.*, 252 U. S. 60. The legislature removed the constitutional objection and reimposed this section by section 351-a.

No fault can be found with the foregoing, as a general definition. It will be discovered, however, that it cannot apply in all cases. The phrase "what constitutes doing business" is somewhat similar to the phrase "due process of law" which appears in the federal Constitution. The courts have refused to define this term, because they have realized that a definition would exclude some unusual cases. The result is that the courts have passed upon the facts in each case and have then ruled as to whether or not there has been a violation of the "due process of law" clause. An examination of the cases, a large number of which are cited later, will show that the courts have been equally hesitant about defining the term "what constitutes doing business." The facts of each particular case must control.

Neither the franchise tax law nor the personal income tax law attempts to define the phrases "doing business" and "business carried on" which are used in these two laws, probably for the reason assigned above. There was evidently a fear on the part of the legislature of including a class of individuals and corporations which would not be taxable and excluding a class which might be taxed.

History and early use of expression "doing business."—It would probably be safe to say that the use of the expression "doing business," or an expression of similar import, relating to the rights of corporations dates back almost as far as corporations themselves. However, it is only in recent years, since corporations have become so numerous and so varied, that the expression has gained great prominence in the courts.

One of the first instances of its appearance in our courts as a source of litigation was in 1884, in the case of *Cooper Manufacturing Co. v. Ferguson*.³ It is indicative that there were few cases to serve as precedents that the court resorted to an abstract definition of the words and said:

³113 U. S. 727.

DECISION. The meaning of the phrase "to carry on" when applied to business is well settled. In Worcester's dictionary the definition is: "To prosecute, to help forward, to continue, as to carry on business." The definition of the same phrase in Webster's dictionary is: "To continue, as to carry on a design; to manage or to prosecute, as to carry on husbandry or trade." The making in Colorado of the one contract sued on in this case, by which one party agreed to build and deliver in Ohio certain machinery, and the other party to pay for it, did not constitute the carrying on of business in Colorado.

In the foregoing case a Colorado statute prohibited foreign corporations from doing business in the state, except on prescribed conditions.

Bouvier's *Law Dictionary*,⁴ defines "doing business" as: "that which occupies the time, attention and labor of men for the purpose of a livelihood or profit."

In the case of *State v. Boston Club*,⁵ the Supreme Court of Louisiana said:

DECISION. The definition of business by the lexicographers is sufficiently broad and comprehensive to embrace every employment or occupation and all matters that engage a person's attention or require his care without the least regard to trade or business. The meaning of the legislators as expressed in the statutes is not as extensive. "Business," in a legislative sense, is that which occupies the time, attention and labor of men for purposes of livelihood or for profit; a calling for the purpose of a livelihood. We will follow the latter meaning in interpreting the statutes relating to license tax.

Principal limitations and factors affecting construction.—

In order to determine the construction to be given the expression as used in the tax laws and in order to measure the value of and determine the inferences to be drawn from its uses in other places, there are certain facts which must be considered in their relation to its use. The importance of this is emphasized when we consider that a foreign corporation may be doing business in the state for some purposes and at the same time not be doing business for other purposes. As was said

⁴Volume I, page 273.

⁵12 So. 895.

in the case of *Cockburn v. Kinsley*,⁶ "Of course it was 'doing business,' but not in the sense intended by the statute," and in the case of *Tauza v. Susquehanna Coal Company*⁷ it was said: "but activities insufficient to make out the transaction of business, within the meaning of those statutes, may yet be sufficient to bring the corporation within the state so as to render it amenable to process."

It is said in the case of *International Trust Company v. American Loan and Trust Company*:⁸

DECISION. It is always an unsafe way of construing a statute to divide it by a process of etymological dissection, into separate words, and then apply to each, thus separated from its context, some particular definition given by lexicographers, and then reconstruct the instrument upon the basis of these definitions. An instrument must always be construed as a whole, and the particular meaning to be attached to any word or phrase is usually to be ascertained from the context, the nature of the subject treated of and the purpose or intention of . . . the body which enacted or framed the statute or constitution.

It is equally true that each use of the expression, when properly analyzed, should shed light on the construction to be given it in any other use.

It is important to be able to understand and determine just what influences and factors affect the meaning of the phrase when used in the tax laws as distinguished from its use in other places.

In the first place, the relation existing between a foreign corporation and a state should be thoroughly understood—that is, what rights, if any, can the corporation demand and what powers can the state assert? In the second place, there should be due regard for the Constitution of the United States and care should be taken that no construction does violence thereto. The most important factors are the clauses of the Constitution prohibiting the states from legislating on matters

⁶135 Pac. 112.

⁷220 N. Y. 259.

⁸65 N. W. 78.

of interstate commerce. Under the general rule of construction that statutes are to be so construed as to harmonize with the Constitution of the United States, it is to be presumed that such was the intention of the legislators, and a statute is not rendered invalid *in toto* merely because the provisions of the Constitution may limit its application.

RELATION OF FOREIGN CORPORATIONS TO THE STATE.—The term “foreign corporation,” as used in the franchise tax law, means a corporation created by the laws of some other state or country and includes both joint-stock companies and associations.⁹

Corporations, being creatures of law, possess only those rights and privileges which the state confers upon them, and they must ever be watchful of the things they can lawfully do in other states and countries, as well as within the borders of their own state.

In the case of *Paul v. Virginia*¹⁰ it was said, speaking of foreign corporations:

DECISION. The recognition of its existence even by other states, and the enforcement of its contracts made therein, depends purely upon the comity of those states.

And in the case of *Horn Silver Mining Company v. United States*¹¹ it was said, after referring to the doctrine set forth in the above case:

DECISION. Only two exceptions or qualifications have been attached to it in all the numerous adjudications in which the subject has been considered, since the judgment of this court was announced in *Bank of Augusta v. Earle*. One of these qualifications is that the state cannot exclude from its limits a corporation engaged in interstate or foreign commerce. . . . The other limitation on the power of the state is, where the corporation is in the employ of the general government.

Generally speaking, it is within the power of a state to exclude, to restrict or to regulate foreign corporations as to

⁹Franchise tax law, section 208.

¹⁰8 Wall. 168.

¹¹143 U. S. 305.

their acts within such state, the only limitations being those contained in the provisions of the federal Constitution. Excepting when prohibited by the provisions of the Constitution and the statutes of a state, principles of comity permit a foreign corporation to enter a state and carry on its business in conformity with local laws and public policy. As is said in *Corpus Juris*.¹²

The rules of comity are subject to local modification by the law-making power. But until so modified, they have the controlling force of legal obligation, and it is the duty of the courts to observe and enforce them until the sovereign otherwise directs. . . . Legislative silence upon the subject is equivalent to permission.

Generally, corporations must register in order to maintain an action at law, but there is no such requirement for individuals and partnerships.

CONSTITUTIONAL LIMITATIONS.—To the general rule of unlimited state control over foreign corporations there are two exceptions, as has been mentioned heretofore, viz.: (1) those engaged in interstate commerce and (2) those in the employ of the federal government. As to corporations which come within the latter class, there is seldom any controversy, but as to those within the former, it is not always easy to determine.

Section 8 of article 1 of the Constitution of the United States, which enumerates the powers of Congress, provided among other things that:

The Congress shall have power . . . to regulate commerce with foreign nations, and among the several states, and with the Indian Tribes. . . .

There are comparatively few corporations whose sole business could be said to be that of interstate commerce; and, as has been frequently held, the mere fact that a corporation is engaged in interstate commerce does not prevent a state from imposing conditions upon that portion of its business carried on within the state which is purely of a local character and is

¹²Volume 14A, page 1216.

not essential to that part of the business which the commerce clause protects.

It is the determination of where interstate commerce ceases and intrastate commerce begins within the meaning of the Constitution that causes the trouble. When the elements can be separated, the rule is plain that the part which is intrastate is within the exclusive jurisdiction of the state and subject to the regulations which it may impose. On the other hand, if the local element is merely incidental to the element of interstate commerce, the whole is protected from restrictive state laws.

In the case of *Hall v. DeCuir*¹³ it was said:

DECISION. The line which separates the powers of the states from this exclusive power of Congress is not always distinctly marked, and oftentimes it is not easy to determine on which side a particular case belongs. Judges not infrequently differ in their reasons for a decision in which they concur. Under such circumstances it would be a useless task to undertake to fix an arbitrary rule by which the line must in all cases be located. It is better to leave a matter of such delicacy to be settled in each case upon a view of the particular rights involved.

But we think it may safely be said that the State legislation which seeks to impose a direct burden upon interstate commerce, or to interfere directly with its freedom, does encroach upon the exclusive power of Congress.

Uses of the expression "doing business" found in statutes. —In New York, as in most states, the expression "doing business" has found three principal uses, viz.:

1. In laws providing for service of process on foreign corporations doing business within the state.
2. In laws of a regulatory nature.
3. In laws imposing license fees and taxes.

¹³95 U. S. 485. See also *Browning v. Waycross*, 233 U. S. 16; *Power Specialty Co. v. Michigan Power Co.*, 157 N. W. 408; *Hogan v. Intertype Corporation*, 206 S. W. 58; *Baltic Mining Co. v. Commonwealth of Mass.*, 93 N. E. 831; *Sherlock v. Alling*, 93 U. S. 102; *Provident Savings Life Assurance Soc. v. Kentucky*, 239 U. S. 103; *Johnston et al. v. Mutual Reserve Fund Life Ins. Co.*, 87 N. Y. S. 438; and *Hopkins v. U. S.*, 171 U. S. 578.

Each of these principal uses has proved a prolific source of litigation, and the cases when properly analyzed and understood should prove helpful to a correct construction of its use in the franchise tax law. Of the three uses, the most liberal construction is found in laws of the first class which relate to service of process. This is due, in the first place, to the fact that such laws as a rule do not impose conditions upon the corporation which would be an interference with interstate commerce and, in the second place, to the fact that the courts seem inclined to put a more strained construction upon the expression for purposes of jurisdiction than for any other. As was said in the case of *Beach v. Kerr Turbine Company*:¹⁴

DECISION. The tendency of legislation and judicial decisions is and has been to make it easy to obtain jurisdiction of foreign corporations.

In order to obtain jurisdiction over a foreign corporation, having neither property nor agent in the state, it is essential that it be doing business in the state. This has been repeatedly held by the United States Supreme Court.¹⁵

In the case of the *International Harvester Company v. Kentucky*¹⁶ it was said:

DECISION. We are satisfied that the presence of a corporation within a State necessary to the service of process is shown when it appears that the corporation is there carrying on business in such sense as to manifest its presence within the state, although the business transacted may be entirely interstate in its character. In other words, this fact alone does not render the corporation immune from the ordinary process of the courts of the state.

And in the case of *Vicksburg, etc., Railway Company v. DeBow*¹⁷ the Supreme Court of Georgia, in defining the expression "doing business," said:

¹⁴243 Fed. 706.

¹⁵*Commercial Mutual Accident Co. v. Davis*, 213 U. S. 245 and cases there cited.

¹⁶234 U. S. 579.

¹⁷98 S. E. 381.

DECISION. What is meant exactly by the requirement "doing business" is not easily determined . . . the question as to whether a foreign corporation is "doing business" in the state, so as to be subject to the jurisdiction of the courts of the state is entirely distinct from the question as to whether such a corporation is "doing business" in the state within the purview of the act prescribing the conditions upon which such corporations may be allowed to do business in the state, and that it does not follow that business which, by reason of the interstate commerce law, does not bring the corporation within the latter statute, may not nevertheless bring it within the statute providing for the service of process.

Flexibility of expression "doing business" and why the facts in each case must control.—In determining whether or not a foreign corporation is doing business in the state, so as to make it subject to the franchise tax, it must first be determined whether or not acts of the corporation relate entirely to interstate commerce or are a necessary incident thereof.

In the case of *Hazeltine v. Mississippi Valley Fire Insurance Company*¹⁸ its wide range of construction was discussed as follows:

DECISION. The English cases also support this judgment and it may be useful to refer to them as showing how the elastic phrase "carrying on business" or "doing business" gives trouble everywhere. . . .

Two comparatively recent decisions of the Court of Appeals of the state of New York afford a good illustration of the flexibility of the expression.¹⁹

Although the facts in the cases were practically the same and the same judge rendered both decisions, in one case it was held that the facts did not constitute doing business in the state and in the other case that such facts did constitute doing business in the state.

What Constitutes Doing Business?

The cases which have been decided on the subject of doing

¹⁸55 Fed. 743.

¹⁹See *International Text Book Co. v. Tone*, 220 N. Y. 313, and *Tanza v. Susquehanna Coal Co.*, 220 N. Y. 259.

business may be classified as answering two questions: (1) What constitutes doing business? (2) What does not constitute doing business? The cases will be discussed in this order.

Generally speaking, if a corporation conducts and concludes in New York a series of transactions or regularly renders services in the state, constituting a substantial portion of its regular business, the corporation is doing business in the state. Occasional business transactions or occasional rendering of services is not sufficient to subject a corporation to the franchise tax law.

One of the most important things to consider in determining whether or not a corporation is doing business in a state is whether or not the acts done constitute a part of the business for which the corporation was organized as shown by its charter. For example, as a general rule the purchase and holding of real estate situated in a state would not constitute doing business, but if such acts as purchasing, leasing, etc., of real estate were among the principal purposes for which the corporation was organized, it is probable that such acts *would* constitute doing business in the state. It is generally recognized that a corporation organized for the purpose of selling merchandise or commodities, in certain places, is considered as doing acts for which it was incorporated, as much in the purchasing of its goods as in the selling of them, the theory being that it could not sell anything which it had not first bought or otherwise acquired in some form from others.

As the business carried on by a non-resident person is not limited, as is that of a corporation, but may assume as many and as varied forms as the person may desire, subject only to the restrictions imposed on residents, the statements in this paragraph are not always applicable to non-resident persons.

The following acts have been held not to constitute doing business in the state:

1. The ownership of stock in a domestic corporation, even though it be a controlling interest.²⁰
2. The endorsement in the state of a note executed in the state²¹ to a foreign corporation.
3. Name of corporation on door and in telephone directory on account of operations which in themselves do not constitute doing business.²²

Erecting of lightning rods.—The case of *Browning v. Waycross*²³ involved the validity of an occupation tax imposed upon lightning rod dealers engaged in erecting lightning rods within the corporate limits of the city of Waycross. The main issue in the case was whether or not the act of erecting the lightning rods constituted a part of interstate commerce so as to preclude jurisdiction by the state. The court said:

DECISION. The general principles by which it has been so frequently determined that a state may not burden by taxation or otherwise the taking of orders in one state for goods to be shipped from another or the shipment of such goods in the channels of interstate commerce up to and including the consummation by delivery of the goods at the point of shipment have been so often stated as to cause them to be elementary. . . .

We are of the opinion that the court below was right in holding that the business of erecting lightning rods under the circumstances disclosed, was within the regulating power of the State and not the subject of interstate commerce for the following reasons:

(a) Because the affixing of lightning rods to houses was the carrying on of a business of a strictly local character, peculiarly within the exclusive control of State authority.

(b) Because, besides, such business was wholly separate from interstate commerce, involved no question of the delivery of property shipped in interstate commerce, or of the right to complete an interstate commerce transaction, but concerned merely the doing of a local act after interstate commerce had completely terminated.

In the following quotation from the same case it is to be noted that the court recognizes the difficulty inherent in any

²⁰*Mannington v. Hocking Valley Ry. Co.*, 183 Fed. 133, 156.

²¹*People's Savings Bank of Bay City v. Fulton Contracting Co.*, 119 N. Y. S. 622.

²²*Rosenblatt v. Bridgeport & Metal Goods Mfg. Co.*, 173 N. Y. S. 331.

²³233 U. S. 16.

attempt to determine exactly where interstate commerce ceases and intrastate commerce begins:

Of course we are not called upon here to consider how far interstate commerce might be held to continue to apply to an article shipped from one state to another, after delivery, and up to and including the time when the article was put together or made operative in the place of destination in a case where because of some intrinsic and peculiar quality or inherent complexity of the article, the making of such agreement was essential to the accomplishment of the interstate transaction.

Installation of superheaters.—In *Power Specialty Company v. Michigan Power Company*,²⁴ a New York corporation brought suit against a Michigan corporation to recover for furnishing and installing six superheaters in the state of Michigan. As the New York corporation had not qualified under the Michigan law so as to entitle it to do business in the latter state, the right of recovery depended entirely on the question whether or not the business was protected as interstate commerce.

In the lower court there had been an instructed verdict for the plaintiff. On the appeal it was argued by the counsel for the appellee that the superheaters were not simple appliances that could have been installed by local workmen, as was the case in *Browning v. Waycross*.²⁵ The Supreme Court reversed and remanded the case for a new trial saying in part:

DECISION. We think the plaintiff has failed to show the necessity of itself installing these superheaters as an essential requisite to the sale of them. . . . There is certainly a necessity for evidence as indicated above to bring a case within the interstate commerce rule. . . .

• **Agents may bring corporation into state by completing transaction.**—As another instance of distinguishing between interstate and intrastate commerce, the following statement of the Supreme Court of Arkansas is of interest:

²⁴157 N. W. 408.

²⁵233 U. S. 16,

DECISION. An interstate transaction contemplates a consignor without and a consignee within a state or vice versa. In the instant case the property was not only retained by the seller after it reached Arkansas, but an agent of the seller was sent to the state for the purpose of demonstrating that the machine would do the work represented, in order to consummate the sale; and, after making a satisfactory demonstration the agent accepted in part payment therefor long-time notes executed and payable at Huntington, Ark., and a mortgage on the machine to secure the notes, which was recorded at Greenwood, Ark. This constituted a business transaction in Arkansas by a foreign corporation contrary to the statute law.²⁶

The question before the court was whether or not the corporation was protected by the interstate commerce privilege so as to entitle it to bring a suit on the contract in the state court. If it had been a question of taxation, instead of one of jurisdiction, the court would doubtless have ruled exactly the same way.

Solicitation of orders by agents.—Perhaps the leading case on what constitutes doing business, so far as process is concerned, is *International Harvester Company v. Kentucky*.²⁷ Sales agents in Kentucky solicited orders subject to approval of a general agent in the home state. They did this, not casually and occasionally, but systematically and regularly. The court decision is in part as follows:

DECISION. In order to hold it (International Harvester Company) responsible under the process of the state court it must appear that it was carrying on business within the state at the time of the attempted service. As we have said, we think it was. Here was a continuous course of business in the solicitation of orders which were sent to another state and in response to which machines of the Harvester Company were delivered within the State of Kentucky. This was a course of business, not a single transaction. The agents not only solicited such orders in Kentucky, but might there receive payment in money, checks or drafts, which notes were made payable and doubtless were collected, at any bank in Kentucky. This course of conduct of authorized agents within the state, in our judgment, constituted a doing of business there in such wise that the Harvester Company might be fairly said to have been there,

²⁶*Hogan v. Intertype Corporation*, 136 Ark. 52; 206 S. W. 58.

²⁷234 U. S. 579.

doing business, and amenable to the process of the courts of the state.

The foregoing case should be compared with an earlier case of the United States Supreme Court, *Green v. Chicago, Burlington and Quincy Railway Company*, discussed under the heading of "What does not constitute doing business."²⁸

Does the making of investments constitute doing business?

—Another interesting tax case, though not involving the franchise tax law, is that of *State Comptroller v. Green*.²⁹ In this case it was held that the decedent, Hetty Green, lending money through corporate fiscal agents, although no office was maintained open to the public, was doing business in the state, so that the capital invested therein was taxable. Briefly, the facts were as follows:

The decedent, who was worth millions of dollars, was a resident of Vermont. She commonly remained in the city of New York, or went there almost daily to make loans through corporations which she had organized to transact her business. She maintained no office open to the public. The question to be determined was whether or not the decedent at the time of her death was engaged in a business within the meaning of the statute, to wit, the business of lending money. She was a conspicuous figure in the financial and business world. It was conceded that she was in the state for the purpose of investing her money, not only in long-term securities, but in collateral notes. She loaned large sums of money for the erection of buildings and for financing various enterprises. The court held that Mrs. Green was doing business in the state of New York, within the meaning of section 220 of the tax law, thereby reversing the lower court, but later respondents were granted leave to appeal to the Court of Appeals where the case is now pending.

²⁸See page 437.

²⁹For decision in lower court, see 171 N. Y. S. 494.

³⁰182 N. Y. S. 190; 183 N. Y. S. 948.

When finally decided, this case will unquestionably take a place of importance among the cases on the subject of what constitutes doing business.

What Does Not Constitute Doing Business

A foreign corporation may be doing business in a state so as to subject it to the process of its courts, and yet not be liable to taxes imposed by that state. In such a case the corporation would be engaged in doing business wholly of an interstate character. The state, of course, cannot place restrictions upon interstate commerce, and the courts have held that the subjecting of such corporations to the process of state courts is a "long way" from restricting interstate commerce.⁸¹

Occasional business transactions or occasional rendering of services is not sufficient to subject a corporation to the franchise tax law. The transactions must be completed within the state. The mere employment of traveling agents to solicit orders and send them to the home office for approval and filling does not constitute doing business in the state so far as the franchise tax is concerned. The fact that an office is maintained in the state for the convenience of the agents soliciting orders to be executed in other states is not sufficient to bring a corporation within the purview of the law.

Solicitation of orders by agents.—Many corporations send their agents into other states for the purpose of soliciting orders for business of various kinds. Some corporations direct these agents to do nothing more than to solicit the orders and send them to the home office to be accepted and filled. Other corporations have their agents do various other things of such a nature as to amount to carrying on a separate and distinct business in the state into which the agents are sent. Many of the cases have been carried to the United States Supreme Court, and it is not always easy to distinguish the de-

⁸¹*International Harvester Co. v. Kentucky*, 234 U. S. 579.

cisions in one case from another. The case of *Green v. Chicago, Burlington and Quincy Railway Company*²² and the case of *International Harvester Company v. Kentucky*²³ furnish very good illustrations of the extremes to which the court has gone on the one hand as to acts that would not constitute doing business and on the other hand as to what would constitute doing business. In the Green case the opinion and facts stated therein are in part as follows:

DECISION. The business for which it was incorporated was the carriage of freight and passengers, and the construction, maintenance and operation of a railroad for that purpose. . . . For the purpose of conducting this incidental business the defendant employed Mr. Heller, hired an office for him in Philadelphia, designated him as district freight and passenger agent, and in many ways advertised to the public these facts. The business of the agent was to solicit and procure passengers and freight to be transported over the defendant's line. For conducting this business several clerks and various traveling passenger and freight agents were employed who reported to the agent and acted under his direction. He sold no tickets and received no payments for transportation of freight. When a prospective passenger desired a ticket, and applied to the agent for one, the agent took the applicant's money and procured from one of the railroads running west from Philadelphia, a ticket for Chicago, and a prepaid order which gave to the applicant, upon his arrival at Chicago the right to receive from the Chicago, Burlington and Quincy Railroad a ticket over that road. Occasionally he sold to railroad employees who already had tickets over intermediate lines, orders for reduced rates over defendant's lines. In some cases for the convenience of shippers who had received bills of lading from the initial line for goods routed over the defendant's lines, he gave in exchange therefor bills of lading over the defendant's line. In these bills of lading it was recited that they should not be in force until the freight had been actually received by the defendant. . . . It is obvious that the defendant was doing there a considerable business of a certain kind, although there was no carriage of freight or passengers. . . .

The business shown in this case was in substance nothing more than that of solicitation. Without undertaking to formulate any general rule defining what transactions will constitute "doing business" in the sense that liability to service is incurred, we think that

²²250 U. S. 530.

²³234 U. S. 579.

this is not enough to bring the defendant within the district so that process can be served upon it.

This case should be contrasted with the decision in the case of *International Harvester Company v. Kentucky*.³⁴ In both these cases the litigation arose over the question of jurisdiction and the decisions, therefore, cannot be considered authority on the question of whether or not the acts involved would come within the protection of interstate commerce on other issues. In fact this was recognized in the opinion in the *International Harvester Company*³⁵ case as follows:

DECISION. We are satisfied that the presence of a corporation within a state necessary to the service of process is shown when it appears that the corporation is there carrying on business in such sense as to manifest its presence within the state, although the business transacted may be entirely interstate in its character.

The cases serve to show that aside from the question of interference with interstate commerce it is yet a very close and debatable question as to what constitutes doing business.

In the cases of *Brennan v. Titusville*³⁶ and *Rearick v. Pennsylvania*³⁷ agents were employed by foreign corporations to solicit business in the state. The agents performed certain duties incidental to carrying out the contracts and delivering the goods.

The case of *Brennan v. Titusville* was tried upon an agreed statement of facts which in part were as follows:

DECISION. 1. J. A. Shephard is a manufacturer of picture frames and maker of portraits residing in Chicago in the State of Illinois, of which state he is a citizen and in which city he has his manufactory, and place of business.

2. In the prosecution of said business he employs agents who, under his direction, solicit orders for pictures and picture frames in the state of Pennsylvania and in other states of the union, by going personally to residents and citizens of the said state of Pennsylvania

³⁴See page 434.

³⁵234 U. S. 579.

³⁶153 U. S. 289.

³⁷203 U. S. 507.

and other states and exhibiting samples of his pictures and frames, going, when necessary from house to house in said state of Pennsylvania, and other states.

3. The defendant, J. W. Brennan, was an agent of the said J. A. Shephard employed by him to travel and solicit orders for said pictures and frames in the manner stated, upon a salary and also upon commission upon the amount of his sales, at the time of his arrest, May 25, 1889. . . .

4. Upon receiving orders for pictures and picture frames the agents of the said J. A. Shephard forwarded the same to him at Chicago, in the state of Illinois, where goods were made and from there shipped by said J. A. Shephard to the purchasers in Titusville, in the state of Pennsylvania, by railroad freight and express, and the price of said goods was collected and forwarded by the express companies and sometimes by the agents to said Shephard at Chicago, in the state of Illinois. . . .

The said J. W. Brennan, at the time of his arrest and before had not been otherwise employed than as stated and was acting solely for the said Shephard.

The question to be determined by the court was whether or not a license tax which the city had attempted to impose upon defendant was a direct burden on interstate commerce and therefore unconstitutional. The court held that the business was of an interstate nature and consequently was not subject to the tax.

The case of *Rearick v. Pennsylvania* was also tried on an agreed statement of facts. They were in part as follows:

DECISION. An Ohio corporation employed an agent to solicit in Sunbury retail orders to the company for groceries. When the company had received a large number of such orders it filled them at its place of business in Columbus, Ohio, by putting up the objects of the several orders in distinct packages, and forwarding them to the defendant by rail, addressed to him for A. B. the customer, with the number of the order also on the package for further identification. The Company ultimately kept the orders, but it kept no books of accounts with the customers, looking only to the defendant. The defendant alone had authority to receive the goods from the railroad and when he received them he delivered them as was his duty, to the customers for cash paid to him. He then sent the money to the corporation. The customer had the right to refuse the goods if not equal to the sample shown to him when he gave the order. In that or other cases of non-delivery the defendant returned the goods to Columbus. No shipments were made to defendant except

to fill such orders and no deliveries were made by him except to the parties named on the packages. . . .

The defendant had no license but relied upon the invalidity of the ordinance.

As in the preceding case, the court held that the defendant was not subject to the tax because the business was of an interstate nature.

In keeping with the decision in the International Harvester Company case³⁸ it would probably have been held in these two cases that the companies were doing business in the state, had the issue been raised on a question of jurisdiction, but, the issue being whether or not the agents could be subjected to a tax, it was held that the business done came within the protection of the interstate commerce rule, and that they were not doing business within the meaning of the statute.

The principles stated in the case of *Brennan v. Titusville*³⁹ referred to above were somewhat extended in the case of *Caldwell v. North Carolina*.⁴⁰ In the latter case pictures and frames were shipped in separate packages, for convenience in packing and handling, to the company's own agent, who fixed the pictures in their proper places or framed and delivered them to the persons ordering them. It was held that these additional acts did not deprive the transaction of its character of interstate commerce.

The following case⁴¹ recently decided by the Supreme Court of the state of Oregon indicates that agents must have power to transact a substantial portion of a corporation's business in order to bring it within the state.

DECISION. In order to constitute doing business within this state by plaintiff, its agent must have had ample authority to transact some substantial portion of plaintiff's business; that is, make complete sales here, and not merely take orders. . . . We do not think that the "robbing of a separator" or the borrowing of fixtures from goods in the original crates or boxes by agents, to be replaced after-

³⁸See page 434.

³⁹153 U. S. 289. See page 438.

⁴⁰187 U. S. 622.

⁴¹*Vermont Farm Machine Co. v. Hall*, 80 Ore. 308; 156 Pac. 1073.

wards without the sanction of the plaintiff being shown, would, of itself, change the nature of the transaction from interstate to intrastate commerce. The real character of plaintiff's business would control in the premises. If it maintained an office and stored its goods in a warehouse in the state, and, through its agents, made sales direct from such repository, no doubt it would be doing business within the state as contra-distinguished from commerce between states.

Relationship between corporation and other parties.—Frequently a case will turn upon the relationship which exists between the foreign corporation and the persons with whom or through whom it deals in another state. In such cases it may be that the parties with whom the corporation directly deals in the state are doing things which unquestionably constitute doing business and which unquestionably are not saved by the presence of elements of interstate commerce. The question may be whether the relationship of principal and agent or the relationship of vendor and vendee exists between the corporation and the parties. If it is that of principal and agent, the corporation will be held to be doing business; if it is that of vendor and vendee, it will be held not to be doing business.

In the case of *Victor Talking Machine Company v. Lucker*⁴² it was said in part:

DECISION. But, taking all of the transactions together, we think the relation of the parties was clearly that of vendor and vendee, and not of principal and agent. The fact that orders taken were turned in to a local dealer to be filled by him as a sale of his own goods, does not change the character of the commerce so long as all sales and deliveries made or contemplated by plaintiff were interstate transactions.

The case of *Badische Lederwerke v. Capitelli*⁴³ is also of interest, especially because of the following statement of the court:

DECISION. Plaintiff's factory is in Germany. It had no office for transaction of business in this state and had no capital invested

⁴²150 N. W. 790.

⁴³155 N. Y. S. 651.

here. It consigns to Maier, who conducted a commission business in the city of Gloversville. He was plaintiff's selling agent, under an agreement which could be terminated by either party on 60 days notice. Purchasers were required to pay directly to the bank, which remitted to plaintiff; but Maier was required to guarantee the payment of all of his sales. He sold goods of the same kind for himself and for others during the time that he was selling for plaintiff, and he alone paid the rent of the place where he conducted his business. It seems to me that he was doing the business and not plaintiff. Finds accordingly.⁴⁴

A corporation often wishes to do business within New York, but does not wish to make a return of its entire business to the state in order to determine the portion of its net income subject to the franchise tax. In order to avoid this the foreign corporation may organize a separate corporation in the state.

If such a corporation is organized, the relationship of "sale," and not "agency," should be created between the two companies. In other words, the parent company should sell the goods outright and not upon consignment or commission, and all collections for goods sold should be received by the subsidiary company.

Do isolated transactions constitute doing business?—The question has frequently been raised as to whether or not isolated transactions constitute doing business in the state. Without going into a detailed discussion of the cases, it can be said that the general rule is that the intention of the corporation in doing an act will have an important bearing on the matter, and that when the act is part of the ordinary business and indicates a purpose to complete other transactions of a like kind it may be deemed to be "doing business" in the state.

In the words of *Corpus Juris*,⁴⁵ in order to constitute doing business, the business done should "be continuous in

⁴⁴See also the case of *Shores Mueller Co. v. Palmer*, 216 S. W. 295.

⁴⁵Volume 14A, page 1373.

such sense as to be distinguishable from mere casual isolated or sporadic transactions such as occasional purchases or sales."

Storage facilities may be maintained—when?—The case of *Brighton Mills v. Knapp*⁴⁶ was recently decided under the present franchise tax law.

DECISION. The relator is a New Jersey corporation, engaged in manufacturing and selling cotton and special fabrics at Passaic, N. J., and its general and business offices are at Passaic, N. J. It imports from abroad Egyptian cotton and from North Carolina Sea Island cotton, to be used in its New Jersey mills. The arriving steamers are lightered and the cotton taken to the Bush Terminal, in Brooklyn. The imported cotton is required by law to be fumigated at the port of entry, and is fumigated in bale at the Bush Terminal until the company needs it at its mills, and as required it is removed to the Passaic mills.

At and before the time of the imposition of this tax the company maintained a New York office, consisting of one room with about \$200 worth of furniture therein. A stenographer was in attendance to keep the office open, to receive cablegrams and messages and transmit them to the New Jersey office and to receive and forward to Passaic any mail that came to that office. Customers sometimes report at the office and the stenographer puts them in touch with the Passaic office. The New York salesman calls at the office occasionally, not oftener than once in a month or two. No books are kept or sales made at this office. No other business is conducted there.

The company was not carrying on business or employing capital in the State of New York. The determination should be reversed and the tax annulled, with fifty dollars costs and disbursements.

Withdrawal of insurance company and continuation of policy contracts.—In the case of *Provident Savings Life Assurance Society v. Kentucky*⁴⁷ it was held, Mr. Justice Hughes delivering the opinion, that an insurance company which had sought to withdraw itself from a state was not doing business within such state, so as to be subject to a license tax, merely because it continued to be bound to policy-holders resident in the state under policies previously issued in such state and

⁴⁶192 N. Y. A. D. 740.

⁴⁷239 U. S. 103.

received renewal premiums upon the policies. Such tax, it was held by the court, would be taxation without jurisdiction and therefore a violation of the fourteenth amendment to the Constitution.

However, in the case of *Johnston et al. v. Mutual Reserve Fund Life Insurance Company*,⁴⁸ in which the question arose on a very similar state of facts as to whether or not the company was doing business within the state so as to be subject to its jurisdiction in cases against the company for breach of contract, it was held that it was doing business within the state.

Office may be maintained within state—when?—The cases make it clear that the mere fact that a foreign corporation maintains an office in a state does not in itself constitute doing business in the state within the meaning of the tax law. The facts may be such that the company can show that all the matters handled through the office in the state and connected therewith relate entirely to interstate commerce and thus immunity may be secured.

Note the following statement taken from the case of *Erie Beach Amusement, Limited, v. Spirella*.⁴⁹

DECISION. The plaintiff, at the time of the making of these contracts and for some time prior thereto, had an office in the City of Buffalo, N. Y., furnished and with two stenographers, and the only evidence as to the business transacted thereat is the making of the first contract and two letters of plaintiff on its printed Buffalo letterhead, and I find that the business transacted at such office was in reference to the transportation of passengers between New York State and Erie Beach, Canada, and matters incidental thereto. . . .

The plaintiff had a perfect legal right to enter the state of New York and do business in foreign commerce, and to maintain an office for the transaction of such business; it is here on such a mission, and the Constitution of the United States protects it in the exercise of such right.

The decisions in the cases also justify the conclusion that

⁴⁸7 N. Y. S. 438.

⁴⁹173 N. Y. S. 626.

a foreign corporation can come into a state, maintain an office at which it handles various matters not connected with interstate commerce, such as entering into contracts which are to be performed entirely without the state or such as the management or conducting in whole or in part of its internal affairs, and yet not come within the meaning of the expression "doing business" in the state, as used in the tax law.

In the case of *Hart v. Foundry Company*⁵⁰ it is said:

DECISION. A corporation dealing with citizens of other states in reference to property situated elsewhere than in the state of Tennessee, and as to which persons and property that state has no concern, cannot be said to be engaged in business in the state of Tennessee, within the meaning and purpose of its statute, even though the parties meet in that state and there agree upon the terms of the contract relative to such business.

The foregoing case involved the validity of a certain contract made in the state of Tennessee by a foreign corporation which had not complied with the Tennessee statute requiring foreign corporations to record their charters in that state before engaging in business therein. It appears, also, that the foreign corporation maintained an office in the state of Tennessee at the time of entering into the contract.

As to the effect of the management of its local affairs within a state, the case of *Manila Electric Railroad and Lighting Corporation v. Knapp et al.*⁵¹ is of interest. The following quotation is taken therefrom:

DECISION. Adverting to the acts and activities of the relator within this state during the year ending October 31, 1916, it is equally manifest that permitting the deposits to remain with the trustee under the agreement of 1903 was not the doing of business in this state or a component of such condition. Nor did the acts of the relator constitute such condition. The assets of the relator consisted of the shares of stock and the obligations of other corporations, foreign in their origin, property and operations, from which, in interest and dividends, its entire income was derived. In New York City it received, deposited and distributed that income to those

⁵⁰72 Miss. 834.

⁵¹229 N. Y. 502.

entitled. In New York City it held meetings of its directors. Each of those activities might as effectively, though not as conveniently perhaps, have been done at the statutory office of Hartford. In the world of business and industry it would not have been thought that they were subject to the interdiction or required for their validity or regularity the franchise of the state. The use or occupation by a foreign corporation of an office in this state for and the exercise there of the management or conducting in whole or in part of its internal affairs is not within the intendment of the Tax Law the doing of business in this state. A foreign corporation may be within this state for corporate purposes and not be doing business here within the meaning of taxing statutes.

Another case of special interest is that of *People ex rel. Dives-Pelican Mining Company v. Feitner et al.*,⁵² decided by the Appellate Division of the Supreme Court of the state of New York. In this case it is said:

DECISION. But this corporation was not doing business in the state of New York in the sense in which that term is used in the statute. The fact that it had an office here and was authorized to do business, did not make it "doing business." The office which it had here was used simply for the purpose of enabling the directors to meet in it and declare dividends upon its preferred stock, and the cash on hand and money in bank was for the purpose of paying such dividends when declared. This is all the business it did in the state of New York, and this, clearly, did not bring it within the statute making it liable to taxation.

Corporations registered may not be doing business.—The question frequently arises as to whether or not a foreign corporation which has registered to do business within the state must because of that fact file a franchise tax return and pay a tax thereon.

A foreign construction corporation secures a contract to erect a building in the state of New York. In order to perform this piece of work it registers to do business in the state. The building is finished during the year and a franchise tax return is made and the tax is paid. The following year the corporation does no business in the state of New York, because it does not bid on or secure any contracts for erecting

⁵²78 N. Y. S. 1017.

buildings. Realizing that it may have need in the future for its registration granting it privilege to do business in the state, the corporation does not withdraw it.

Section 209 says that "for the privilege of doing business in this state, every foreign corporation . . . shall annually pay . . . a . . . franchise tax."

Section 214, among other things, provides that "every foreign corporation doing business in this state . . . shall be subject to a minimum tax." It should be noted that this last section does not use the phrase "for the privilege of doing business," but states that only those corporations doing business must pay the minimum tax.

It would therefore appear that if a foreign corporation actually transacts no intrastate business, although it may be registered, it is not required to file a return. As was said in the case of *People ex rel. Dives-Pelican Mining Company v. Feitner*.⁵³

The fact that it had an office here and was authorized to do business, did not make it "doing business."

⁵³See page 446.

CHAPTER XXII

DETERMINATION OF NET INCOME, RATES AND COMPUTATION OF THE TAX

The franchise tax on corporations is based on the entire net income¹ as arbitrarily defined in the law. For convenience the net income reported to the federal government is used as a starting point. As heretofore stated, the tax is levied upon the privilege of doing business or exercising a franchise; therefore, the adjustment of net income to include Liberty bond interest and dividends is not deemed to tax such items as income.

But inasmuch as the tax increases as the income increases, Liberty bond interest and dividends are virtually taxed at the rate of $4\frac{1}{2}$ per cent per annum.

Corporations not organized under the laws of any state in the United States must report their *entire net income* rather than the amount returned to the United States Treasury Department.² For federal purposes alien corporations are obliged to report only income from sources within the United States.

LAW. Section 209. [Corporations subject to the tax] shall annually pay in advance for the year beginning November 1 an annual franchise tax, to be computed by the tax commission upon the basis of its entire net income for its fiscal or the calendar year next preceding, as hereinafter provided, which entire net income is presumably the same as the entire net income upon which such corporation is required to pay a tax to the United States, or as otherwise provided by section two hundred and fourteen³ of the tax law, except⁴ that the entire net income of a corporation not organized under the laws of any state within the United States which shall be taken as the basis of computation by the tax commission shall

¹Except when the "one mill," or minimum, tax applies. See page 454.

²Section 209.

³"Computation of tax," see page 456 *et seq.*

⁴This provision was added by Laws of 1920, chapter 640, effective May 10, 1920.

be the entire net income in fact rather than the amount earned in the United States or the amount returned to the United States Treasury Department.

"Entire Net Income" Defined

The courts have held⁵ that income and excess profits taxes paid to the federal government are not deductible in determining net income for the purpose of computing the New York state franchise tax, as provided in the following:

LAW. Section 208. . . .

3. The term "entire net income" means the total net income before any deductions have been made for taxes paid or to be paid to the Government of the United States on either profits or net income or for any losses sustained by the corporation in other fiscal or calendar years whether deducted by the government of the United States or not.

The amount of "entire net income" returned to the United States government is shown in schedule A, form 1120, for 1920, page 1, item 27, except in the case of those corporations having a deduction from income under section 23, Merchant Marine Act of 1920. In the latter case the amount reported as item 29 is to be used for state purposes.

Personal service corporations will report the amount of net income shown on form 1065, item 26.

Net losses sustained in other years.—Section 204 of the federal law permits any corporation which sustained a net loss in any taxable year beginning after October 31, 1918, and ending prior to January 1, 1920, to deduct such net loss from the income of the preceding taxable year. If the income of such preceding year is less than the amount of such net loss, the balance of the loss may be deducted from the net income of the succeeding year.

Item 11, form 3 IT, provides for reporting the amount of "losses sustained in prior years."

⁵*People ex rel. Barcalo v. Knapp*, 187 N. Y. App. Div. 89; Court of Appeals, 227 N. Y. 64.

The net loss allowed by the federal government may affect the income of several years, but section 208 quoted above specifically provides that such losses may not be deducted in computing the "entire net income" upon which the state franchise tax is based.

Inventory losses—claim in abatement.—Section 234 (a-14) of the federal law permitted a corporation to file a claim in abatement based on the fact that it had sustained a loss due to a material reduction in the value of the inventory at the end of 1918. The state tax commission ruled⁶ that the income reported in the federal return might not be reduced, for state purposes, by the amount of such abatement claim prior to the final determination of the claim by the Internal Revenue Department. Such an inventory loss, however, is not of the class which may not be deducted under section 208. When the 1918 net income for federal purposes is finally adjusted the state tax can be correspondingly adjusted, and if the net income for 1918 as reported to the state was excessive a claim for refund should be made.

Interest on obligations of the United States and dividends received from domestic corporations.—The form (3 IT) prescribed for reporting for the tax year beginning November 1, 1920, provides for showing, in addition to the income reported to the United States Treasury, item 9, dividends received from domestic corporations and from foreign corporations subject to tax by the United States and, item 10, tax-exempt interest on federal obligations.⁷

The amount of dividends to be shown as item 9 of form 3 IT for state purposes will be the amount reported as item 25 of federal form 1120. A personal service corporation, however, should not report any dividends under item 9 of form 3 IT, as they are already included in the net income reported to

⁶Ruling dated August 11, 1919.

⁷Previous forms did not require these data.

the federal government (item 26, schedule A, form 1065. This amount will have been entered as item 8, form 3 IT.

RULING. Replying to your inquiry, as to what income from Federal or other bonds may be deducted in a corporation's return of net income, permit me to advise that—

Article 9-A of the tax law is neither in language nor intent an "income tax." . . .

The question of the deduction of interest or income from Federal bonds, under a franchise tax law, was passed upon conclusively in *Monroe Savings Bank v. City of Rochester*, 37 N. Y. 365, 369, 370. See also *Society for Savings v. Coite*, 6 Wall. 594, pages 606, 607; *Insurance Company v. N. Y.*, 119 U. S. 129, 134 U. S. 594; *Wallace v. Myers*, 38 Fed. Rep. 184; *Institution v. Mass*, id. 631, etc. (Extract from letter addressed to The Corporation Trust Co., signed by Commissioner John J. Merrill, and dated March 22, 1920.)

The statement of the state Tax Commissioner in the foregoing ruling that "Article 9-A of the tax law is neither in language nor intent an 'income tax'" is more academic than real. As the court said in a recent case:⁸ "the tax imposed upon this franchise must be held in practical operation to be a tax upon income." The important point, however, is that the tax-exempt Liberty bond interest and dividends must be added back to income reported to the federal government.

RULING. Question. Referring to Section 209 of Article 9-A of the Franchise Tax Law, information is requested as to whether the assessment is levied on the net income of a corporation before deducting interest on United States obligations or whether the assessment is levied on the net income after deducting interest on obligations of the United States. For example:

(1) Net Income of corporation per books,	\$10,000
(2) Less interest on obligations of the United States entirely exempt from tax,	1,000
(3) Balance—Net Income subject to excess profits tax,	9,000
(4) Less interest on obligations of the United States ex- empt from income tax,	2,000
(5) Balance—Net Income subject to income tax (Be- fore deducting excess profits tax and \$2,000 ex- emption),	\$8,000

⁸*The People of the State of New York ex rel. Alpha Portland Cement Co., Respondent v. Walter H. Knapp et al.* (decided November 23, 1920). This decision is quoted in full in Appendix B.

Is the State Franchise tax assessed on Item 1, 3 or 5, and which amount should be reported in answer to Question (8) on Form 3-IT?

Answer. In reply to your letter of July 15, you are advised:

The Franchise tax in the case cited will be based upon the item of \$10,000. The total amount of interest on obligations of the United States referred to in items (2) and (4) of your letter should be inserted in report on Form 3-IT in connection with item No. 10.

The item of \$8,000 evidently constitutes the proper answer to Item No. 8 of the franchise tax report.

The franchise tax is based upon the entire net income of the corporation without regard to any deductions on account of exemptions or of exempt income so far as the United States Treasury Department is concerned. (Letter of inquiry from Leslie, Banks & Company, New York, N. Y., and the reply thereto signed by Deputy Commissioner N. W. Canfield, and dated July 17, 1920.)

The foregoing regulations have been modified, however, in so far as corporations organized under the laws of states other than New York are concerned, by the decision of the Court of Appeals of New York in the case of *Alpha Portland Cement Company v. Walter H. Knapp et al.* The decision in this case, quoted in Appendix B, was handed down by Justice Cordozo on November 23, 1920.

In brief, this decision holds that in the case of a foreign corporation all interest on bonds is to be excluded from the income upon which the franchise tax is computed. This is predicated upon the fact that the assets (bonds) have a situs outside the state of New York and also upon the fact that in providing for the allocation⁹ of the income as between New York State and elsewhere, the cost or value of the bonds is excluded from the computation.

The decision also holds that the limitation placed upon the value of shares of stock in allocating income to the state of New York is invalid.

In a recent ruling¹⁰ the Attorney-General stated that it was the present plan to present an application to the Court of

⁹Section 214, see page 457.

¹⁰Opinion of Attorney-General, dated January 25, 1921.

Appeals for a reargument of the Alpha Portland Cement Company case. (See page 471.)

Entire net income of alien corporations.—Under the federal law, corporations not organized in the United States are required to pay income tax only on income from sources within the United States¹¹ and to return such income only.¹²

Section 209 of the state law was amended in 1920 thus:

LAW. Section 209. . . . except that the **entire net income of a corporation not organized under the laws of any state within the United States which shall be taken as the basis of computation by the tax commission shall be the entire net income in fact rather than the amount earned in the United States or the amount returned to the United States treasury department.**

The foregoing means that such foreign corporations will be required to report their income from all sources, but will of course be taxed only on that part allocated to sources within the state.

Correction of net income reported in federal return.—When the federal return is audited by the Treasury Department, in many cases the amount of net income reported in the original return is corrected or changed. If this occurs the state law¹³ provides that within ten days after receipt of notice of such correction or change of net income the corporation must report the fact to the state Tax Commission with a statement that the change is accurate, or, if not accurate, wherein it is erroneous. The law also provides that the Tax Commission shall then determine the correct net income for the year affected by the change, restate the tax and, if an excessive amount was paid, the corporation credited therewith.

In numerous instances corporations file amended federal returns, either on their own initiative or under instructions from the Commissioner of Internal Revenue. Usually a long

¹¹Federal law, section 233 (b).

¹²Federal law, section 217.

¹³Section 219, d.

time elapses before the revenue agents are able to audit the amended returns. Until the Treasury shall have audited the amended returns, it will not be necessary to advise the state Tax Commission of a "change" in net income reported to the federal government, for such a change may never occur. Technically, taxpayers may be under an obligation to inform the state Tax Commission whenever they receive notices from the federal Commissioner that additional taxes are to be assessed. In practice, however, it would be unreasonable to believe that the New York law requires any adjustment of returns other than a final adjustment. The A-2 letter from the federal Commissioner is not notice of a "change"; it is merely a notice of a proposed change, and taxpayers may and do frequently contest such proposed additional assessments.

If a taxpayer in good faith notifies the state Tax Commission as soon as notice is received that a *definite* change or correction has been made in the federal return, it cannot be claimed that the state law is not observed.

Rate of Tax

LAW. Section 215. **The tax imposed by this article shall be at the rate of four and one-half per centum¹⁴ of the entire net income of the corporation or portion thereof taxable within the state, determined as provided by this article, unless taxable upon its capital stock at the rate of one mill or subject to the minimum tax of ten dollars, as provided in section two hundred and fourteen of the tax law.**

Minimum tax.—If a corporation has no net income or has a deficit, it is still subject to the franchise tax, the theory being that every domestic corporation exercising its franchise and every foreign corporation doing business in the state must pay a tax for the privilege.

¹⁴[**Former Procedure**] The rate was increased from 3 per cent by chapter 628, Laws of 1919, effective May 14, 1919. The 3 per cent rate was in effect from the time when the New York franchise tax law was enacted, June 4, 1917, until the amendments approved May 14, 1919, increased the rate to 4½ per cent.

LAW. Section 214.

7. It is further provided that **every domestic corporation** exercising its franchise in this state and **every foreign corporation** doing business in this state, other than those exempted by section two hundred and ten of this chapter, **shall be subject to a minimum tax of not less than ten dollars and not less than one mill upon each dollar of such a part of its issued capital stock**, at its face value, as the amount of its gross assets employed by it in its business in this state bears to its gross assets wherever employed by it in its business. If such a corporation has stock without par value, then the base of the tax shall be such a portion of its issued capital stock as its gross assets employed in its business in this state bear to the entire gross assets employed in its business, and its shares without par value shall be deemed to have a face value of one hundred dollars each for the purposes of this assessment.

If such a corporation is subject to a tax at the rate of one mill, and it maintains no regular place of business outside this state, except a statutory office, it shall be taxed upon its entire issued capital stock as herein provided.

There are therefore three rates of tax, the corporation paying whichever is highest, as follows:

1. Corporations doing business entirely within the state:
 - (a) $4\frac{1}{2}$ per cent on entire net income.¹⁵
 - (b) One mill on each dollar of face value of issued stock.
 - (c) Minimum tax of \$10.
2. Corporations doing business partly within and partly without the state:
 - (a) $4\frac{1}{2}$ per cent of the amount of entire net income taxable within the state.¹⁶
 - (b) One mill on each dollar of face value of issued stock apportioned to the state.¹⁷
 - (c) Minimum tax of \$10.

Stock without par value is deemed, for the purpose of assessing the "one mill" tax, to have a par value of \$100 a share.

¹⁵For definition of "entire net income," see page 449 *et seq.*

¹⁶For apportionment of income to the state, see page 457.

¹⁷Issued stock is apportioned on the basis of *gross assets* within and without the state.

To illustrate: A corporation doing all its business in the state might have a deficit for the taxable year; yet if it had \$100,000 of issued stock it would pay, under the "one mill" tax, \$100. On the other hand, a foreign corporation, having no net income (doing business both within and without the state) and having only \$2,000 of its capital stock apportioned to the state, would nevertheless be subject to a minimum tax of \$10. In the latter case the minimum \$10 tax is higher than the "one mill" tax, which would amount to only \$2.

Computation of Tax

When entire business is transacted within the state.—The words "if imposed upon the entire net income" were added by amendment in 1920 to the following section of the law. They make it clear that if not imposed on net income, the "one mill" tax or the minimum tax of \$10 will apply.¹⁸

LAW. Section 214. If the entire business of the corporation be transacted within the state, the tax imposed by this article, if imposed upon the entire net income, shall be based upon the entire net income of such corporation for such fiscal or calendar year as defined in section two hundred and eight¹⁹ of this chapter subject, however, to any correction thereof for fraud, evasion or error, as ascertained by the state tax commission. . . .

When business is transacted within and without the state.—Not only is net income arbitrarily defined in the law, but when a corporation transacts only part of its business within the state, the allocation of income to the state is also made on an arbitrary basis. The method is defined at great length in the law and consists, first, in determining the proportion that certain classes of assets allocated to the state bear to the total assets of the same classes wherever located. The resulting proportion or fraction is then applied to the entire net income,

¹⁸See page 455.

¹⁹See page 449.

and the $4\frac{1}{2}$ per cent rate applied to such sum results in the tax payable.

As a matter of fact the taxpayer makes the segregation on form 3 IT and the computation of the tax is made by the state Tax Commission. There is no place provided on the form for showing either the proportion of assets allocated to New York or the amount of tax payable.

Segregation of assets.—The law specifically provides what elements shall enter into the computation.

LAW. Section 214. If the entire business of such corporation be not transacted within the state, the tax imposed by this article shall be based upon a proportion of such entire net income, to be determined in accordance with the following rules: The proportion of the entire net income of the corporation upon which the tax under this article shall be based, shall be such portion of the entire net income as the aggregate of

1. The average monthly value of the real property and tangible personal property within the state.

2. The average monthly value of bills and accounts receivable arising from (a) personal property sold by the corporation from merchandise manufactured by it within this state; (b) personal property owned by the corporation and not manufactured by it within this state but sold by it or its agents and located within the state at the time of the receipt of the order; (c) the purchase or sale of, or trading in, goods, wares or merchandise not located at any place at which the corporation conducted a permanent or continuous business without the state, and where the bills and accounts receivable arose from orders received or accepted by any officer or agent, or at any place of business, in this state; and (d) services performed by any officer, agent or representative of the corporation connected with, sent from, or reporting, either directly or indirectly, to any officer located in this state or at any office located, owned, rented or occupied in this state.

3. The proportion of the average value of the stocks of other corporations owned by the corporation, allocated to the state as provided by this section, but not exceeding ten per centum of the real and tangible personal property segregated to this state under this article, bears to the aggregate of

4. The average monthly value of all the real property and tangible personal property of the corporation, wherever located.

5. The average total monthly value for the fiscal or calendar

year of bills and accounts receivable arising from (a) personal property sold by the corporation from merchandise manufactured by it within and without this state; and (b) the purchase, or sale of, or trading in, personal property, or from services performed by the corporation, its officers or agents, excluding those arising in any way from advances or loans.

6. The average total value of stocks of other corporations owned by the corporation, but not exceeding ten per centum²⁰ of the aggregate real and tangible personal property set up in this report. . . .

The wording of the law is involved. The first step to be taken is to determine the proportion which the aggregate of the items mentioned in subdivisions 1, 2 and 3 bears to the aggregate of the items mentioned in subdivisions 4, 5 and 6. Once the ratio is obtained, the remainder of the computation is comparatively simple.

In order to show the various steps in the computation a concrete case has been taken for illustrative purposes and the figures have been set up on the return form.

Before proceeding to the actual segregation, however, two important definitions must be noted and the principle by which monthly average values are reached must be understood.

“Tangible personal property”—definition of.—

LAW. Section 208.

2. The words “tangible personal property” shall be taken to mean corporeal personal property, such as machinery, tools, implements, goods, wares and merchandise, and shall not be taken to mean money, deposits in bank, shares of stock, bonds, notes, credits or evidences of an interest in property and evidences of debt;

“Average”—definition of.—

RULING. The word “average” wherever it appears in this report has its plain, ordinary significance; neither the highest amount nor the lowest, but the mean. The same method employed in determining average assets should be used in determining average liabilities. (Statement from State Tax Department, by Deputy Commis-

²⁰The limitation on the value of stocks of the other corporations to 10 per cent of the real and tangible property, stated in subsections 3 and 6 of section 214, was added by the Laws of 1918; it did not appear in the 1917 law.

sioner N. W. Canfield, authorized for publication September 27, 1920.)

Determination of average monthly values.—The word “average” is used in each one of the six subdivisions of section 214 prescribing the items entering into the computation.

The “average” monthly values may be obtained ordinarily from the monthly trial balances by dividing the sum of such balances for the taxable year by twelve. The monthly sales, after excluding cash sales, will usually represent the value of the accounts and bills receivable for the month. If this is not so, an analysis of the actual accounts and bills receivable will be necessary in order to determine the character of the sales from which they arose, for purpose of classification required by the law.

Tangible personal property generally may be taken at book value.

If real estate and stocks of other corporations are carried on the books at figures different from their actual values, it will be necessary to adjust them to their correct average actual value instead of using the book figures.

VALUATION OF REAL AND TANGIBLE PERSONAL PROPERTY.—

LAW. Section 214.

7. Real property and tangible personal property shall be taken at its actual value where located.

Illustration of segregation of assets.—Assume that the XYZ Corporation, having an office and factory in the city of New York, also maintains an office and warehouse in Philadelphia. All sales as made are reported to the New York office, but sales made by the Philadelphia office are shipped from a stock of goods maintained at the Philadelphia warehouse.

The starting point is the corporation's balance sheet, which is as follows:

FRANCHISE TAX ON CORPORATIONS

BALANCE SHEET OF THE X Y Z CORPORATION

AS OF DECEMBER 31, 1920

ASSETS

Cash		\$ 90,000.00
Accounts Receivable	\$280,000.00	
Less: Reserve for Bad Debts.....	10,000.00	270,000.00
Notes Receivable		80,000.00
Inventories:		
Raw Material and Supplies.....	\$120,000.00	
Goods in Process	90,000.00	
Finished Goods	360,000.00	
Goods on Consignment	40,000.00	610,000.00
U. S. Liberty Bonds (par \$80,000) market value.....		72,000.00
Stocks of domestic corporations (book value \$200,000) market value		160,000.00
Fixed Assets:		
Land	\$100,000.00	
Buildings	450,000.00	
Machinery and Equipment	200,000.00	
Furniture and Fixtures	30,000.00	
	<u>\$780,000.00</u>	
Less: Reserves for Depreciation:		
Buildings	\$80,000.00	
Machinery and Equipment.....	40,000.00	
Furniture and Fixtures	5,000.00	
	<u>\$125,000.00</u>	
Net value		655,000.00
Deferred Charges		15,000.00
Total		<u><u>\$1,952,000.00</u></u>

LIABILITIES

Accounts Payable	\$110,000.00	
Notes Payable	80,000.00	
Mortgage Payable	300,000.00	
Accrued Expenses	20,000.00	
Reserve for Taxes	130,000.00	
Total		\$640,000.00

CAPITAL

Capital Stock	\$500,000.00	
Surplus	812,000.00	
Total		1,312,000.00
		<u><u>\$1,952,000.00</u></u>

Real property.—The value of the real property (net of depreciation) shown by the balance sheet is \$470,000. This amount is represented by:

Factory in New York	\$420,000.00
Warehouse building in Philadelphia	50,000.00
Total	<u>\$470,000.00</u>

The law²¹ provides, however, that real property and tangible personal property shall be taken at its actual value where located.

The land carried on the balance sheet at \$100,000 has appreciated in value to.....	\$200,000.00
and an appraisal shows the actual value of New York factory buildings to be	<u>450,000.00</u>
Total segregated to New York State, to be entered on page 2 of form 31T	\$650,000.00
Actual value of the Philadelphia warehouse, which is constructed on leased land, is taken at the book value of.....	<u>50,000.00</u>
Total, "wherever located," to be entered on page 2, of form 31T	<u>\$700,000.00</u>

Tangible personal property.—The balance sheet shows that in addition to inventories the items coming under this head are:

Machinery and Equipment (net of depreciation).....	\$160,000.00
Furniture and Fixtures (net of depreciation).....	25,000.00
Total	<u>\$185,000.00</u>

All of the machinery and equipment is at the factory in New York. If the machinery account shows numerous changes during the year, the average will have to be obtained from the twelve monthly trial balances, by adding the amount shown in the account each month and dividing by twelve. Furniture and fixtures to a value of \$10,000 are at the Philadelphia office and warehouse. The averaging method must be applied to this asset also if there has been any considerable variation in the account during the year.

²¹Section 214; see page 459.

INVENTORIES.—All raw materials and supplies are kept at the factory in New York. As a result of averaging this account by months, as previously described, the average monthly value is found to be considerably greater than the amount shown on the balance sheet at the end of the year, viz., \$170,000. The amount of goods in process is difficult to ascertain at any one time, and it is only when a good cost system is in operation that it is possible to obtain correct monthly figures. The monthly average of this account for the year is shown to be somewhat more than is indicated by the balance sheet, viz., \$100,000. About 10 per cent of the goods in process may be allocated to the Philadelphia warehouse, because a finishing process is given the goods in Philadelphia. This process represents about 1 per cent of the total cost of manufacturing.

Finished goods, as shown by the monthly trial balances, averaged \$350,000 for the year, somewhat less than is shown by the balance sheet at the end of the year. The average of the monthly value of the goods stored at the Philadelphia warehouse is \$190,000. Deducting this amount from \$350,000 leaves \$160,000 allocated to New York.

The goods out on consignment show an average monthly value of \$30,000 and represent shipments made to dealers outside the state. Such consignments are properly part of the inventory to be taken at cost price and should not be treated as accounts receivable.

The foregoing items of tangible personal property may be summarized as follows:

	SEGREGATED	To
	New York	Wherever Located
Machinery and Equipment	\$160,000.00	\$160,000.00
Furniture and Fixtures	15,000.00	25,000.00
Inventories:		
Raw Materials and Supplies	170,000.00	170,000.00
Goods in Process	90,000.00	100,000.00
Finished Goods	160,000.00	350,000.00
Goods Out on Consignment		30,000.00
Totals	<u>\$595,000.00</u>	<u>\$835,000.00</u>

The above totals may now be entered on page 2 of form 3 IT in the spaces provided.

It is to be noted that bonds are expressly excluded from the definition of "tangible personal property" in the law²² and are not included in any other classification of assets to be included in the computation. This eliminates the item Liberty bonds shown on the balance sheet.

Stocks of other corporations.—The stocks shown on the balance sheet cost \$200,000 and had a market value of \$160,000 at the end of the year. The average monthly value of the stocks, however, as ascertained from quotations throughout the year, was \$190,000.

LAW. Section 214. . . .

7. . . . **The value of share stock of another corporation owned by a corporation liable hereunder shall for purposes of allocation of assets be apportioned in and out of the state in accordance with the value of the physical property in and out of the state representing such share stock. . . .**

The other corporations whose stocks are held as above have physical property within the state of a value amounting to only one-fourth of the total value of the corporations' physical property, wherever located. Therefore, only one-fourth of \$190,000, or \$47,500, is allocated to New York State. There should be entered on page 2 of form 3 IT on the last line of the schedule "total segregated assets wherever located" \$190,000 and on the last line of schedule "assets segregated to New York State only" \$47,500.

It should be noted that it is the *value* of the physical property within and without the state that governs the allocation. This may be a very different figure from the actual quantity, e.g., a small proportion only of the physical property may be within the state, but it may be very valuable when compared with the total value of all the physical property wherever located.

²²Section 208, 2.

LIMITATION OF 10 PER CENT.—Under the law²³ the value placed on the stock of other corporations is limited to 10 per cent of the real and tangible property of the reporting corporation. For example, the \$190,000 above mentioned is limited to 10 per cent of the total real and tangible property (\$700,000 plus \$835,000, or \$1,535,000), viz., \$153,500. The value of the stock segregated to the state, \$47,500, is also limited to 10 per cent of the real and tangible property segregated to the state (\$650,000 plus \$595,000, or \$1,245,000), viz., \$124,500. In the second instance there would be no reduction.

The state Tax Commission makes the computation of the 10 per cent limitation. If the taxpayer does not know the value of the physical property within and without the state, the state Tax Commission will supply this information.

In a recent decision of the New York Court of Appeals,²⁴ however, it was held in the case of a foreign corporation that the 10 per cent limitation on the value of stocks of other corporations, both in the segregation within the state and the total, is inoperative.

Bills and accounts receivable.—The law specifies four classes of bills and accounts receivable that are to be segregated to the state, i.e., those arising from:

1. Property sold by the corporation, from merchandise manufactured by it within the state.
2. Property manufactured without the state, owned by the corporation, sold by it or its agents and located within the state at the time of receipt of order.
3. Property sold or traded in by the corporation, not located at any place at which the corporation conducted a permanent or continuous business without the state, and where the orders were received or

²³Section 214, 3 and 6; see page 457.

²⁴*People ex rel. Alpha Portland Cement Co. v. Knapp*, 129 N. E. 202, See Appendix B.

accepted by any officer or agent, or at any place of business in the state.

4. Services performed by any officer or representative of the corporation reporting to any officer or office located in the state.

Usually the sales during the month, less cash sales, will represent the accounts and bills receivable, so that an analysis of the sales into the four classes enumerated above will enable the taxpayer to determine how the bills and accounts receivable arose and the proportion to be allocated to each class. If the sales for the month do not correctly reflect the average values of the bills and accounts receivable, the actual amounts in the accounts and bills receivable accounts should be taken.

Bills and accounts receivable arising from loans and advances are to be excluded.

The principal difficulty in classification arises in connection with items (3) and (4) above.²⁵ For instance, in the case of a corporation selling goods which it did not own and later purchasing to cover, such transactions were held to come under class (4) for purposes of the segregation.²⁶ A foreign corporation, acting as selling agent for manufacturers entirely on a commission basis, employed salesmen, who forwarded orders direct to manufacturers located without the state, who filled the orders.

As duplicate copies of the orders were received at the New York office, however, the Commission held that bills and accounts receivable arising from such sales should be segregated to New York State because "the corporation receives its notice of sales made by it through its agents at its New York office."²⁷

ACCOUNTS NOT TO BE TWICE INCLUDED.—Another important point in the segregation is not to include the same ac-

²⁵See notes on the use of form 3IT, page 470.

²⁶Ruling of the state Tax Commission, dated October 2, 1919.

²⁷Ruling of the state Tax Commission, dated December 18, 1919.

counts in more than one classification. For example, it is possible by a literal interpretation of section 214²⁸ to include the same accounts and bills receivable under more than one classification. Such a procedure was actually followed by the state Tax Commission under the law before the recent amendments.

DECISION. In the case of this relator it so happens that a large portion of its accounts receivable are for goods "manufactured or sold within the state," and that these goods are likewise "sold from its stores or stocks within the state." Accordingly the state tax commission, in making the figures for the proportion, used the accounts receivable for these goods both under item "a" and under item "b" in each term of the second ratio, thus duplicating the accounts, with a result which, owing to the large sales made by the relator within the state, has been greatly to its disadvantage. In other cases it might well happen that corporate receipts from sales outside the state would prove to be large, while receipts for sales within the state would be small, in which cases duplications, such as made here, would be distinctly disadvantageous and unfair to the state. It cannot be reasoned, therefore, that these duplications were provided for intentionally, in order to serve the self-interest of the state. Indeed, no reason or theory can be advanced which would make the method of computation employed other than a senseless and arbitrary scheme of calculating state-earned net income.

Nor does it seem to me that a proper reading of the section requires, or even permits, the method. Its terms provide for calculating accounts and bills receivable derived from three sources, and, as these sources are separately classified under the separate headings of "a," "b," and "c," the conclusion is unavoidable that each class is intended to be exclusive, and that what is reckoned under class "a" is not to be counted under class "b," or vice versa. It was not material whether the goods in question were counted under "a" or under "b"; but if counted under one, they should not have been counted under the other. Therefore, I think the determination of the state tax commission was erroneous. The determination is reversed.²⁹

Goods manufactured partly within and without the state.

—In case of goods manufactured without the state and re-

²⁸See page 457.

²⁹*People ex rel. Société Anonyme des Anciens Etablissements, E. & E. Chapal Freres & Cie. v. Knapp et al. State Tax Commission* (Supreme Court Appellate Division, Third Dept., May 5, 1920).

quiring only about 1 per cent of the total cost of manufacturing in a finishing process which the goods received within the state, the Tax Commission held that only 1 per cent of the accounts receivable arising from the sales of such goods need to be segregated to New York State.⁸⁰

The balance sheet⁸¹ at the end of the year shows accounts and bills receivable amounting to \$350,000, but the average monthly value determined from the monthly trial balances as previously described is \$420,000. Upon analyzing the sales it is found that the sales on the average arose in the following manner and with approximately the percentages shown:

1. From goods manufactured in New York and sold from New York	30%
2. From goods manufactured in New York but sold from Philadelphia warehouse	40
3. From goods purchased for resale by the New York office and located in New York at time of receipt of order.....	10
	80%
4. From goods purchased by Philadelphia office and stored at Philadelphia warehouse, the orders being received and accepted by the Philadelphia office	20
	100%

From the above analysis it is apparent that 80 per cent of the bills and accounts receivable should be segregated to New York and 20 per cent should be allocated without the state.

To ascertain the amount to be entered as "assets segregated to New York" on page 2 of form 3 IT, the distribution is made as follows:

Line (a) 70 per cent of \$420,000.....	\$294,000.00
Line (b) 10 per cent of \$420,000.....	42,000.00
Total bills and accounts receivable segregated to New York	\$336,000.00
In the schedule "total segregated assets wherever located" should be entered on line (a)	\$336,000.00
and on line (b) the bills and accounts receivable segregated without the state and not arising from sale of manufactured goods	84,000.00
Total bills and accounts receivable, wherever located.....	\$420,000.00

⁸⁰Letter signed by Deputy Commissioner N. W. Canfield, dated November 20, 1920.

⁸¹See page 460.

Determination of tax.—The following schedule consisting of page 2 of form 3 IT, made in accordance with the foregoing explanation, shows: (1) total assets segregated to New York State of \$1,628,500, and (2) total segregated assets, wherever located, of \$2,145,000. The ratio of (1) to (2) is 75.92074 per cent. Assuming the entire net income of the corporation to be \$200,000, the 75.92074 per centage applied thereto gives the amount of the entire net income allocated to New York State, viz., \$151,841.48, which is subject to tax at $4\frac{1}{2}$ per cent. The tax is, therefore, $4\frac{1}{2}$ per cent of \$151,841.48, or \$6,832.87.

However, the computation is not made by the taxpayer but by the state Tax Commission.

SEGREGATION OF ASSETS

Note: This segregation must be made unless the consent under Paragraph 18, Page 1, has been signed.

TOTAL SEGREGATED ASSETS WHEREVER LOCATED

(a) Average total monthly value for the fiscal or calendar year of bills and accounts receivable arising from personal property sold by the corporation from merchandise manufactured by it within and without this state.....	\$ 336 000 00			
(b) Average total monthly value for the fiscal or calendar year of bills and accounts receivable arising from the purchase, or sale of, or trading in, personal property, or from services performed by the corporation, its officers or agents, excluding those arising in any way from advances or loans.....	\$ 84 000 00			
†Average monthly value of all its real property wherever located (actual value).....	\$ 700 000 00			
†Average monthly value of all its tangible personal property wherever located (actual value).....	\$ 835 000 00	NOT TO BE FILLED		
Total.....	\$ 1 955 000 00			
‡Average total actual value of shares of stocks of other corporations owned by this corporation.....	\$ 190 000 00			
ASSETS SEGREGATED TO NEW YORK STATE ONLY				
(a) Average monthly value of bills and accounts receivable arising from personal property sold by the corporation from merchandise manufactured by it within this state.....	\$ 294 000 00			
(b) Average monthly value of bills and accounts receivable arising from personal property owned by the corporation and not manufactured by it within this state but sold by it or its agents and located within the state at the time of the receipt of the order.....	\$ 42 000 00			
(c) Average monthly value of bills and accounts receivable arising from the purchase or sale of, or trading in, goods, wares or merchandise not located at any place at which the corporation conducted a permanent or continuous business without the state and where the bills and accounts receivable arose from orders received or accepted by any officer or agent, or at any place of business, in this state.....	\$			
(d) Average monthly value of bills and accounts receivable arising from services performed by any officer, agent or representative of the corporation connected with, sent from, or reporting, either directly or indirectly, to any officer located in this state or at any office located, owned, rented or occupied in this state.....	\$			
†Average monthly value of its real property within this State as detailed in this report (actual value).....	\$ 650 000 00			
†Average monthly value of its tangible personal property in New York State as detailed in this report (actual value).....	\$ 595 000 00	NOT TO BE FILLED		
Total.....	\$ 1 581 000 00			
‡Average total actual value of shares of stocks of other corporations owned by it and allocated to this State by rule below.....	\$ 47 500 00			

† Real property and tangible personal property shall be taken at its actual value where located.

‡ The value of shares of stock of another corporation owned by a corporation liable hereunder shall for purposes of allocation of assets be apportioned in and out of the State in accordance with the value of the physical property in and out of the State representing such share stock.

Note.—If the amount of the annual net income of any corporation taxable under this article as returned to the United States treasury department is changed or corrected by a commissioner of internal revenue or other officer of the United States, such corporation, within ten days after receipt of such notification of change or correction, shall make return under oath or affirmation to the Tax Commission of such changed or corrected net income upon which the tax is required to be paid to the United States.

Computation of the alternative (one mill) tax.—As previously stated, a corporation doing business within the state

must pay the highest tax shown by one of three different computations:

1. Tax of $4\frac{1}{2}$ per cent on net income.
2. Tax of one mill on each dollar of face value of capital stock allocated to New York State.
3. Minimum tax of \$10.

The law⁸² provides in the case of a foreign corporation that the "one mill" tax is to be based on "such a part of its issued capital stock, at its face value, as the amount of its gross assets employed by it in its business in this state bears to its gross assets, wherever employed by it in business."

In making the segregation of assets for the "one mill" tax, the basis is the *gross* assets within and without the state. The following schedule on page 2 of form 3 IT requires information as to three classes of current assets, but presumably the items of real property and personal property are to be inserted by the Tax Commission from information contained in the schedule of segregation of assets on page 2 of form 3 IT.

NOTE CAREFULLY:

The segregation below need not be made by

1. Any corporation whose entire assets or business are in New York State.
2. Any corporation consenting under paragraph (18) of this blank.
3. Any corporation whose tax upon its entire net earnings would be greater than upon its issued capital stock at one mill, as apportioned under Article 9-A of the Tax Law.

SEGREGATION FOR ONE MILL TAX ONLY

ASSETS IN NEW YORK STATE		ASSETS OUTSIDE NEW YORK STATE	
(a) Average monthly bank and cash balance employed during the year.....	\$ 60,000.00	(a) Average monthly bank and cash balance employed during the year.....	\$ 30,000.00
(b) Average value of bills and accounts receivable during the year.....	\$ 336,000.00	(b) Average value of bills and accounts receivable during the year.....	\$ 84,000.00
(c) Average value of bonds, loans on call and other financial securities held, used or employed in New York during the year.....	\$ 119,500.00	(c) Average value of bonds, loans on call and other financial securities held, used or employed outside the State of New York during the year.....	\$ 42,500.00
Total of above.....	\$	Total of above.....	\$
R. E.....	\$	R. E.....	\$
P. P.....	\$	P. P.....	\$
	\$		\$
</			

⁸²Section 214, (7); see page 455.

The complete details of the segregation within and without the state, although not required by the form, are as follows:

	Within the State	Without the State
Cash	\$60,000.00	\$30,000.00
Bills and Accounts Receivable.....	336,000.00	84,000.00
Liberty Bonds	72,000.00	} 142,500.00
Stocks	47,500.00	
Real Property	650,000.00	50,000.00
Tangible Personal Property	595,000.00	240,000.00..
Total	<u>\$1,760,500.00</u>	<u>\$546,500.00</u>

In the case of a domestic corporation the bonds are allocated to New York State because the situs of the bonds is deemed to be the same as that of the principal place of business of the corporation.

Stocks, however, are allocated in the same manner as that provided for the segregation for the purpose of the $4\frac{1}{2}$ per cent tax on net income, i.e., on the basis of the value of the physical assets (located within and without the state) of the corporations whose stocks are owned.

The letters "R. E." and "P. P." apparently mean "Real Property" and "Tangible Personal Property," respectively, used in the previous segregation. Assuming this, the assets segregated to New York for the "one mill" tax will amount to \$1,760,500 and the assets outside New York will amount to \$546,500, a total of \$2,307,000. The tax may be computed as follows:

$$\frac{\$1,760,500.00}{\$2,307,000.00} \times \$500,000.00 \text{ (issued capital stock)} \times \$0.001 = \$381.56$$

The "one mill" tax, however, is not applicable in this instance as the $4\frac{1}{2}$ per cent tax is larger in amount.

Notes on the use of form 3 IT.—

RULING. All questions must be answered either by inserting the proper figures or the words "yes" or "no" or "none," as may be correct.

Care should be taken to properly designate the location of property.

Any corporation taxable upon its entire income or entire capital stock under this law may omit the "Segregation of assets" on page 2 of the official report blank and the "Segregation for one mill tax only" on page 3.

Any corporation whose tax upon its entire net earnings apportioned to this state would be greater than the one mill tax upon capital stock apportioned to this state, as provided in Article 9-A of the tax law, may omit the "Segregation for one mill tax only" on page 3.

In making the segregation to New York State, on page 2, the bills and accounts receivable should be apportioned to (c) and (d) as follows:

New York State Only

(c) This item includes bills and accounts receivable arising from the sale of goods owned by the company having no taxable situs outside of New York but in transit or temporarily stored for distribution and sold under the conditions as to receipt or acceptance of orders expressed in the law.

(d) This item includes bills and accounts receivable arising from sales of goods not owned by the corporation, or from services. Bills and accounts receivable "from services" means those arising essentially from the activities of the corporation's officers or agents rather than from the employment of capital in the ownership of goods, wares and merchandise. (Extracts from a letter to The Corporation Trust Company, signed by State Tax Commission, by Commissioner John J. Merrill,* and dated June 1, 1920.)

BANK AND CASH BALANCE EMPLOYED IN STATE.—If a bank or cash balance is kept within the state and used in the ordinary course of the business, it is deemed to be employed in the state. If, however, it is absolutely dormant, it is deemed not to be employed in the state.³³

Note re Alpha Portland Cement case.—The following extract from a letter dated March 2, 1921, shows how the Tax Department is interpreting the decision:

The department considers that if the value of the bonds are included and considered in reference to the location, the objection of the court will be removed in regard to inclusion of interest derived from such bonds.

³³Ruling of the state Tax Commission, dated July 2, 1920.

CHAPTER XXIII

RETURNS AND PAYMENT OF THE TAX

Returns

Returns must be made by: (1) every corporation subject to the tax,¹ and (2) every foreign corporation "having officers, agents or representatives within the state." The visits paid by the officer of a foreign corporation to points within the state have been held not to constitute acts requiring the foreign corporation to report.² However, the test indicated by the rulings of the state Tax Commission is whether or not the foreign corporation is doing business within the state.³

Time and place of filing returns.—

LAW. Section 211. Every corporation taxable under this article as well as foreign corporations having officers, agents or representatives within the state shall annually on or before July first, or within thirty days after the making of its report of entire net income to the United States treasury department for any fiscal or calendar year, preceding said first day of July, transmit to the tax commission a report in the form prescribed by the tax commission. . . .⁴

The words "preceding said first day of July" were added by amendment in 1920, and make clear that the net income to be reported to the state is that reported for the taxable year of the corporation ended prior to July 1.

Returns by new corporations.—

RULING. . . . this department would advise that a corporation organized under the laws of this state and commencing business on June 30, 1919, should show its condition on June 30, 1919. This means that it should show the property of the various kinds called for by the law and to which it actually had title on June 30, and

¹For exempt corporations, see page 418.

²Ruling of the state Tax Commission, dated July 1, 1919.

³For discussion of "what constitutes doing business," see Chapter XXI.

⁴Form 3-IT has been prescribed by the Commission, and is reproduced in Appendix A.

should give no consideration to the property which it took over while in the hands of the individual owners. (Letter to The Corporation Trust Co., signed by Commissioner John J. Merrill, and dated July 26, 1919.)

The corporation would have no income but it would be liable to the minimum tax.⁵

In the case of a corporation filing its certificate with the Secretary of State at Albany on June 29 and the duplicate certificate of incorporation in New York County on July 8, it was held that⁶ such corporation should report if any capital stock was outstanding at June 30.

Foreign corporation transacting business without license.

—On the question of whether or not a foreign corporation doing business in the state prior to July 1, without a license, and registering subsequent to July 1, is required to file a return July 1 and pay tax the following November, the state Tax Department has ruled that the date on which it began doing business controls.

RULING. No delinquent notices are being sent out to Domestic Corporations organized subsequent to July 1 of any year. If said Corporations receive delinquent notices, it is because they were sent out in error.

Foreign Corporations, however, which register in New York subsequent to July 1 of any year, but which have prior to that date been transacting business in New York State without a license, and which therefore are required to file returns for the tax year beginning November 1, do receive the delinquent notices regardless of the date which they are registered in New York. In other words, the date on which a Foreign Corporation begins doing business in New York State is controlling, and not the date upon which it receives its license to transact business. (Statement from State Tax Department, by Deputy Commissioner N. W. Canfield, authorized for publication September 27, 1920.)

Returns of corporations in dissolution.—Under the federal capital stock tax law, which is a tax on corporations “with respect to carrying on or doing business,” corporations which

⁵See page 454.

⁶Ruling of the state Tax Commission, dated August 22, 1919.

have ceased to do business are not taxable. Unlike this federal law, however, the New York franchise tax is a tax on domestic corporations for the privilege of exercising their franchises in this state; therefore, domestic corporations which are inactive or in the process of dissolution are required to make returns and are taxable. If there were profits for the preceding year, the tax would be on the basis of "entire net income." If there were no profits, the tax would be on the basis of the minimum tax.

Domestic corporations surrendering their franchises or discontinuing the exercise of the same on or before October 31 in any year are not taxable, because the tax is payable in advance for the year beginning November 1. No tax is refundable if a corporation surrenders its franchise or ceases to exercise it during the year.

In regard to the filing of a return when dissolution has been effected prior to July 1, the state Tax Commission has ruled as follows:

RULING. A corporation dissolved prior to July 1st unless its assets or franchise are taken over by another corporation need not file a report but should advise the tax commission under oath of its dissolution and that its assets or franchise were not acquired by another corporation. (Ruling of the State Tax Commission, dated August 13, 1919.)

INACTIVE OR DEFUNCT CORPORATIONS.—Form 3 IT contains the following instructions relative to furnishing affidavits in cases of such corporations:

Any corporation which has never issued any stock or has disposed of all its assets and abandoned its charter must file an affidavit equivalent in substance to form 30 of this department which will be supplied upon request. Simply to write "out of business," "never began business," "dead," et cetera, is not a sufficient compliance to relieve from the penal provisions of the statute.

Taxation of corporations acquiring assets or franchises of other corporations.—

LAW. Section 214-a. If any corporation taxable under this article shall acquire either directly, indirectly or by merger or consoli-

dation the major portion of the assets or the franchise of another corporation or of corporations exercising any franchise or franchises or doing any business in this state during any year, it shall include in its own next annual return, in addition to its own entire net income so much of the entire net income of the corporation or corporations whose assets or franchises it acquired as shall not have been used or included in measuring a franchise tax to this state, and shall be taxed upon such combined entire net incomes for the year to ensue and as hereinbefore provided. The provisions for a minimum tax shall be applied only when under such provisions a tax will result in excess of the amount which would be produced by a tax on entire net income as hereinbefore provided and then in lieu thereof.

This section shall be construed as having been in effect as of the date of the original enactment of article nine-a of the tax law, as added by chapter seven hundred and twenty-six of the laws of nineteen hundred and seventeen.

The essence of the foregoing provision is that if one corporation either directly or *indirectly* by some form of merger or consolidation acquires the major portion of the assets of another corporation, so much of the net income of the latter as has not already been used in measuring a franchise tax to the state must be included in the return of the acquiring corporation.

Returns by affiliated corporations.—The law as amended in 1920 contains a new subsection⁷ describing at length the conditions under which a consolidated return may be required. In general, the principles governing the preparation of consolidated returns under the federal law⁸ are applicable. There is also a provision under which the Commission “may require such facts as it deems necessary” when as a result of intercompany control or relationship the net income has been affected by selling its products “at less than a fair price.” This evidently is to cover those cases in which an attempt is made to adjust the net income through intercompany charges.

⁷Section 211 (9).

⁸See *Excess Profits Tax Procedure*, 1921, page 282 *et seq.*

LAW. Section 211. . . .

9. Any corporation owning or controlling, either directly or indirectly, substantially all of the capital stock of another corporation, or of other corporations, liable to report under this article, may be required to make a consolidated report showing the combined entire net income, such assets of the corporations as are required for the purposes of this article, and such other information as the tax commission may require, but excluding intercorporate stockholdings and intercorporate accounts.

The tax commission may permit the filing of a combined report where substantially all the capital stock of two or more corporations liable to taxation under this article is owned by the same interests. The tax commission may impose the tax provided by this article as though the combined entire net income and segregated assets were those of one corporation, or may, in such other manner as it shall determine, equitably adjust the tax. . . .

Prior to the enactment of the above amendment, it was questionable whether or not in any case consolidated returns could be required.

RULING. Replying to your inquiry, in which you ask how the provision in the franchise tax law based upon income which contemplates that the net income returned for taxation shall be the entire amount of net income returned to the United States, can be complied with where several corporations have filed a consolidated return for the United States tax, this department would advise you that the ruling of the department in such cases has been that where a corporation was made the selling agent in this state for the output of another corporation, such business constituted the business of the company for which a corporation acted as a selling agent, and that such combined net income was contrary to the presumption in the tax law of this state. In such a case the parent company would be taxable upon the basis of the combined net income, apportioned as provided by the statute, and the subsidiaries would be taxable under the minimum provision of the act.

Where two or more corporations do not bear the relation of principal and agent or subsidiary, each corporation should make a report showing its own entire net income because the presumption in the statute that the return made to the Federal government is the correct return, under the statutes of this state is refuted by the facts in the case. (Letter to The Corporation Trust Co., signed by Commissioner John J. Merrill, and dated June 23, 1919.)

The foregoing ruling appears to conflict with the decisions of the courts defining the meaning of the term "doing busi-

ness.”⁹ The state of New York cannot tax a foreign corporation not doing business within the state, nor can it require a return from such corporation. Consolidated returns need not be filed unless all the affiliated corporations are doing business within the state. The law attempts to reach only corporations “taxable under this article” and the Tax Commission cannot by construction extend the law. It must be remembered that the federal consolidated return is based upon the separate reports of the corporations forming the group. Those doing business in the state of New York should file returns in the state but the others are not subject to the New York law.

The amendment to the law, it is to be observed, gives the Tax Commission very limited discretion as to whether or not a consolidated return should be filed because of the words “liable to report under this article.” In other words, only New York corporations or corporations doing business in New York are affected.

AFFILIATION THROUGH BUSINESS RELATIONSHIPS.—The following provision of the law covering cases in which financial or business relationships may result in manipulation of the net income through intercorporate transactions is similar to the federal procedure under the 1917 law, but the federal law now makes the requirement for affiliation depend entirely on stock ownership.

LAW. Section 211. . . .

9. . . . Where any corporation liable to taxation under this article conducts the business whether under agreement or otherwise in such manner as either directly or indirectly to benefit the members or stockholders of the corporation, or any of them, or any person or persons, directly or indirectly interested in such business by selling its products or the goods or commodities in which it deals at less than a fair price which might be obtained therefor, or where such a corporation, a substantial portion of whose capital stock is owned either directly or indirectly by another corporation, acquires and disposes of the products of the corporation so owning the substantial portion of its capital stock in such a manner as to

⁹See Chapter XXI.

create a loss or improper net income, the tax commission may require such facts as it deems necessary for the proper computation provided by this article, and may for the purpose of the act determine the amount which shall be deemed to be the entire net income of the business of such corporation for the calendar or fiscal year, and in determining such entire net income the tax commission shall have regard to the fair profits which, but for any agreement, arrangement or understanding, might be or could have been obtained from dealing in such products, goods or commodities.

The procedure of the state Tax Commission relative to requiring or accepting consolidated reports is indicated in the following:

RULING. In reply to your request regarding consolidated returns, permit me to say:

The provisions of section two hundred and eleven (§211) of the tax law relative to combined reports are so formulated as to leave to the discretion of the state tax commission the determination as to whether or not such reports would result in a fair and equitable assessment, measured by earnings.

The determination rests upon the location and character of the business of the controlling and controlled corporations, as provided in §211 of the tax law.

Generally speaking, any corporation should advise with the tax department before filing a combined report or should file a combined report for the parent or controlling company, together with separate reports for each of the corporations whose income and assets are included in the combined report.

The purpose of combined reports is to adjust equitably taxes upon all corporations involved in the combined reports, and such combined reports are received subject to acceptance or rejection, as the commission decides whether or not the result is equitable and fair both to the state and to the taxpayers. (Letter to The Corporation Trust Company, signed by Commissioner John J. Merrill, and dated October 7, 1920.)

What must be reported?—

LAW. Section 211. Every corporation taxable under this article shall annually transmit a report in the form prescribed by the tax commission, specifying: 1. The name and location of the principal place of business of such corporation, the state under the laws of which organized, and the date thereof; the amount of its issued capital stock and the kind of business transacted. Any corporation not organized under the laws of any state within the United States shall state the facts in relation to its entire net

income wherever earned and as though organized under the laws of this state, and instead of stating its income as returned to the United States treasury department.

2. The amount of its entire net income for its preceding fiscal or the preceding calendar year as shown in the last return of annual net income made by it to the United States treasury department, except as provided in subdivision one of this section. If the corporation shall claim that the return made to the United States treasury department was inaccurate, the amount claimed by it to be the net income for such period shall be specified. If any deduction has been allowed for losses sustained by the corporation in prior years the amount so allowed and deducted shall be specified. . . .

Although a foreign corporation is taxed under the federal law only on income earned within the United States, the state law as it now stands requires a return of entire net income from all sources. It is believed that this provision was added in order to determine the proportion that income from sources within the state bears to income from all sources.

Section 211 of the law also provides that the report shall contain a segregation of the following classes of assets to the state and to the total wherever located:

1. Real property and tangible personal property.
2. Bills and accounts receivable of certain classes.
3. Stock of other corporations.

Section 214 of the law¹⁰ repeats in substance the language of section 211 as to segregation of assets in determining the proportion of net income to be assigned to the state.

The report must also show the location of the real property and tangible personal property "in each city, village or portion of a town outside of a village; within the state." This distribution enables the Tax Commission to apportion the tax revenues to the various political subdivisions of the state.

If the corporation has no real or tangible personal property within the state, then the place where its financial business is transacted must be reported.

¹⁰See page 457.

WHEN SEGREGATION MAY BE OMITTED FROM REPORT.—

LAW. Section 211. . . .

8. Any corporation taxable hereunder upon its entire net income may omit from its report the statements required by subdivisions four and five by incorporating in its report a consent to be taxed upon its entire net income. . . .

If the corporation has assets located without New York state, the "consent" (item 18 of form 3 IT) should not be signed. In that case segregation of the assets must be made.

It is important to note, however, that if a corporation has no net income, the segregation of assets must nevertheless be made to determine the alternative (one mill) tax.

LAW. Section 211. . . .

8. . . . Corporations having no net income shall, however, complete the segregation of assets in every case. . . .

SPECIAL RETURNS MAY BE REQUIRED.—

LAW. Section 211. . . .

7. Such other facts as the tax commission may require for the purpose of making any computation required by this article, or for the purpose of comparison with former reports to determine whether or not such reports were erroneous or fraudulent. . . .

The latter part of the foregoing subdivision was added by amendment in 1920.

A foreign corporation which is no longer doing business in New York State, because of the withdrawal of its certificate of authority or the sale of all of its assets located within New York State, is required to file form 15.¹¹ The form is filed "for the purpose of having the name of the corporation eliminated from the list of those required to file annual returns."

A domestic corporation which has sold its assets, and dissolved or abandoned its charter should file form 30.¹²

AMOUNT OF AVERAGE INDEBTEDNESS FOR THE YEAR.—

Item 6 of form 3 IT¹³ calls for the amount of average indebt-

¹¹See Appendix A.

¹²See Appendix A.

¹³See Appendix A.

edness for the year. What useful purpose such information serves has not been disclosed by the state Tax Commission. The method of averaging assets previously described¹⁴ may be used in ascertaining the average indebtedness.

Reports may be made on basis of fiscal year.—

LAW. Section 212. A corporation which reports to the United States treasury department on the basis of its fiscal year, may report to the tax commission upon the same basis, except as provided in section two hundred and fourteen-a of this chapter.¹⁵

As the taxable income is based chiefly on the federal returns it would be impracticable to require reports for periods other than those covered in the federal returns.

RULING. . . . In reply to your letter of June eighteen relative to the filing of tax returns under Article 9-a of the tax law, permit me to say:

The report to the Federal Government which covers a year between June 30 of one year and July first of the succeeding year, whether for a fiscal or a calendar year, constitutes the basis of the assessment for the year to ensue. To illustrate: If a corporation has had a fiscal year ending April 30, 1919 its report to the Federal Government for that fiscal year is the last one due to be made to the Federal Government prior to July 1, 1919, and would be taken as the basis of assessment for the tax year of the State beginning on November first succeeding.

A corporation whose fiscal year ending August 31, 1920 would file a report with this department on the basis of its fiscal year ending August 31, 1919, but as the corporation is permitted until November 15, 1919, to file that report, there is no reason why it could not make a complete report to this department at any time between November 1, 1919 and July 1, 1920.

The tax to the state for the year beginning November 1, 1920 is not based upon any fiscal year ending after the first day of July, 1920, but upon the last fiscal year preceding that date.

I trust I make myself clear when I state that any company using a fiscal year after July 1, 1919 and prior to July 1, 1920 should include its net income and its assets for the last preceding fiscal or calendar year ending before July 1, 1920, and I think you may use this last sentence as additional information upon this subject.

¹⁴See page 458.

¹⁵Section 214-a refers to corporations acquiring assets or franchises of other corporations. (See page 474.)

(Letter to The Corporation Trust Company, signed by Commissioner John J. Merrill, and dated June 22, 1920.)

TABULATION BASED ON THE FOREGOING RULING.—The following statement sets forth in tabulated form the status, so far as the present question is involved, for the taxable year beginning November 1, 1921, of a corporation with a fiscal year ending on any one of the respective dates shown. Naturally the official form for a particular tax year must have been issued and be available before return may be made.

Corporation with

Fiscal year ended	July 31, 1920	} files with state at any time on or before July 1, 1921, for assessment for year beginning November 1, 1921, on basis of return to Federal Government for year ended as stated.
" " "	Aug. 31, 1920	
" " "	Sept. 30, 1920	
" " "	Oct. 31, 1920	
" " "	Nov. 30, 1920	
" " "	Dec. 31, 1920	
" " "	Jan. 31, 1921	} files with state on or before July 1, 1921, or within 30 days after filing Federal return for year ended as stated for assessment for year beginning November 1, 1921.
" " "	Feb. 28, 1921	
" " "	Mar. 31, 1921	
" " "	Apr. 30, 1921	
" " "	May 31, 1921	} files with state within 30 days after filing Federal return for assessment for year as above stated.
" " "	June 30, 1921	

Extension of time may be granted for filing returns.—

LAW. Section 217. The tax commission may for good cause shown extend the time within which any corporation is required to report by this article. . . .

If a corporation secures an extension of time in which to file its federal return, the time within which the report must be made to the state is automatically extended.

RULING. You are advised that under §211 of the tax law it is provided that every corporation taxable under Article 9-a of the tax law shall annually on or before July first, or within thirty days after the making of its report of entire net income to the United States Treasury Department for any fiscal or calendar year transmit

to the tax commission a report in the form prescribed by the tax commission.

The foregoing language has been construed by the state tax department to mean that when an extension has been granted by the United States Treasury Department, an extension of thirty days beyond the date of the filing of the report with the Federal government automatically takes place. In other words, if a corporation's report is due to be filed with the Federal government on June fifteenth, it has until July fifteenth in which to file its report with the state tax department, and if the Federal government grants a special or further extension to such corporation, it is automatically entitled to that extension and thirty days additional in which to file its report with this department. . . . (Letter to The Corporation Trust Company, signed by Commissioner John J. Merrill, and dated July 1, 1919.)

Returns must be under oath.—

LAW. Section 213. Every report required by this article shall have annexed thereto the affidavit of the president, vice-president, secretary or treasurer of the corporation to the effect that the statements contained therein are true. . . .

Blank forms furnished by the state Tax Commission on application.—

LAW. Section 213. . . . Blank forms of the report shall be furnished by the tax commission, on application, but failure to secure such a blank shall not release any corporation from the obligation of making a report herein required. The commission may require a further or supplemental report under this article to contain further information and data necessary for the computation of the tax herein provided.

It is the practice of the state Tax Commission to mail the return forms to corporations. If they are not received, application for the forms should be made to the Commission.

RULING. The franchise tax report of corporations under Article 9-a of the tax law, based on the calendar year ending December 31, 1920, is not due until July 1st, 1921, and blanks for such report will not be ready for distribution until about June 1st, 1921. At that time blanks in duplicate will be mailed to all corporations appearing upon department's active list. (Letter to The Corporation Trust Company, signed by Deputy Commissioner N. W. Canfield, and dated January 17, 1921.)

PENALTY FOR FAILURE TO REPORT.—

LAW. Section 216. Any corporation which fails to make any report required by this article shall be liable to a penalty of not more than five thousand dollars to be paid to the state, to be collected in a civil action, at the instance of the tax commission; and any officer of any such corporation who makes a fraudulent return or statement with intent to defeat or evade the payment of the taxes prescribed by this article shall be liable to a penalty of not more than one thousand dollars, to be collected in like manner. All moneys recovered as penalties, for a failure to report or for making fraudulent reports shall be paid to the state comptroller.

In order to compromise the specific penalty (as distinguished from the interest penalty imposed by section 219-c) the delinquent taxpayer will use form 8 IT.¹⁶

When Tax Is Payable

The law ¹⁷ provides that on or before December 1 the Tax Commission shall determine the tax and notice of the assessment shall be mailed to the corporation. Payment must then be made as follows:

LAW. Section 219-c. The tax hereby imposed shall be paid to the state comptroller on or before the first day of January of each year, or within thirty days after notice of the tax has been given as provided in section two hundred and nineteen-b of this chapter if such notice is given subsequent to the first day of December of the year for which such tax is imposed. . . .

While the state Tax Commission determines the amount of tax, payment is made to the state Comptroller. Legislation now pending would place in the hands of the state Tax Commission the collection of taxes heretofore vested in the Comptroller.

Payment of tax when consolidated return is filed.¹⁸—A new subsection was added in 1920 to section 214 of the law,

¹⁶See Appendix A.

¹⁷Section 219-a.

¹⁸Section 211 (9), provides that consolidated returns may be required; see page 476.

providing that the Tax Commission may assess the tax against "either" of the reporting corporations in the consolidated return. If there are more than two corporations in the consolidation, presumably the tax may be assessed against any one of them.

LAW. Section 214. . . .

In case any report is made as provided by subdivision nine of section two hundred and eleven of the tax law, the tax commission may assess the tax against either of the corporations whose assets or net income are involved in the report and upon the basis of the combined entire net income and the combined segregated assets of the corporation and upon such other information as it may possess, or may adjust the tax in such other manner as it shall determine to be equitable. . . .

CHAPTER XXIV

ADMINISTRATION

The administration of the franchise tax law and the collection of the tax are vested in the state Tax Commission. This body consists of three commissioners, one of whom is president.¹

Powers of Tax Commission.—The section of the law quoted below defines certain of the powers given to the Tax Commission, but it must be read in connection with various other provisions throughout the law so as to determine the full scope of the Tax Commission's authority.

LAW. Section 217. The tax commission may for good cause shown extend the time within which any corporation is required to report by this article. If any report required by this article be not made as herein required, the tax commission is authorized to make an estimate of the net income of such corporation and of the amount of tax due under this article, from any information in its possession, and to order and state an account according to such estimate for the taxes, penalties and interest due the state from such corporation.² All the authority and powers conferred on the tax commission by the provisions of section one hundred and ninety-five of the tax law shall have full force and effect in respect of corporations which may be liable hereunder.

Section 195 of the tax law, mentioned above, so far as pertinent to the franchise tax law, reads as follows:

LAW. Section 195. . . . The commission shall also have power to examine or cause to be examined, in case of a failure to report or in case the report is unsatisfactory to it, the books and records of any such corporation, joint-stock company, . . . and may hear testimony and take proofs material for its information, and may appoint a commissioner by a written appointment under its official seal for that purpose. Every commissioner so appointed shall be authorized

¹Section 170, article 8, of the tax laws.

²In amending this section, the provision granting the right of hearing when the tax was based on an estimate was eliminated.

to make such examination and take such testimony and hear such proofs and report the proofs and testimony so taken and the result of his examination so made and the facts found by him to the commission. The commission shall, therefrom, or from any other data which shall be satisfactory to it, order and state an account for the tax due the state, together with the expenses of such examination and the taking of such testimony and proofs. Such expenses shall be fixed and adjusted by the commission.

Assessment.—

AUDIT AND STATEMENT OF TAX.—

LAW. Section 219-a. On or before the first day of December in each year the tax commission shall audit and state the account of each corporation known to be liable to a tax under this article, for its preceding fiscal or the preceding calendar year, and shall compute the tax thereon and forthwith notice the same to the state comptroller for collection. The tax commission shall determine the portion of such tax to be distributed to the several counties and the amounts to be credited to the several cities or towns thereof, when the same is collected, and shall indicate such determination in noticing such tax to the state comptroller. If the corporation has real property or tangible personal property located in a village, or if it has no real or tangible personal property in the state but the office in which its principal financial concerns within the state are transacted is located in a village, the tax commission shall indicate such facts to the state comptroller, with the name of the village in which such office or property is located.

It is to be noted that the above section of the law requires the Tax Commission to compute and assess the tax not later than December 1. The following section requires that notice of the assessment then be sent by mail to the taxpayer.

Notice of tax.—

LAW. Section 219-b. Every report required by section two hundred and eleven of this chapter shall contain the post-office address of the corporation and lines or spaces upon which the corporation shall enter its entire net income. Notice of tax assessment shall be sent by mail to the post-office address given in the report, and the record that such notice has been sent shall be presumptive evidence of the giving of the notice and such record shall be preserved by the tax commission.

Since the taxpayer has until January 1, or until the expi-

ration of 30 days after notice of tax has been given to pay the tax, the date of receipt by him of the notice is material.

Tax is payable within thirty days after notice.—

LAW. Section 219-c. The tax hereby imposed shall be paid to the state comptroller on or before the first day of January of each year, or within thirty days after notice of the tax has been given as provided in section two hundred and nineteen-b of this chapter if such notice is given subsequent to the first day of December of the year for which such tax is imposed. . . .

Penalties for failure to pay.³—

. . . . If such tax be not so paid, or in the case of additional taxes, if not paid within thirty days after notice of such additional tax has been given as provided in section two hundred and nineteen-d of this chapter and such notice of additional tax is given subsequent to the first day of December of the year for which such additional tax is imposed, the corporation liable to such tax shall pay to the state comptroller, in addition to the amount of such tax, or additional tax, ten per centum of such amount, plus one per centum for each month the tax or additional tax remains unpaid, but the state comptroller upon submission to him of satisfactory proof that the failure to pay such taxes, or additional taxes, within the time prescribed in this article, was not wilful or evasive, may modify the exaction to not less than one per centum for each month following the due date of the tax. . . .

The part of this section which provides for a modification of penalty upon submission of satisfactory proof that failure to pay was not wilful nor evasive is new matter added by the 1920 amendments.

Tax is a lien on the property.—

LAW. Section 219-c. . . . Each such tax or additional tax shall be a lien upon and binding upon the real and personal property of the corporation liable to pay the same from the time when it is payable until the same is paid in full.

Powers of the Tax Commission when a return is not filed or is unsatisfactory.—

LAW. Section 217. . . . If any report required by this article

³For form 8IT see Appendix A.

be not made as herein required, the tax commission is authorized to make an estimate of the net income of such corporation and of the amount of tax due under this article, from any information in its possession, and to order and state an account according to such estimate for the taxes, penalties and interest due the state from such corporation. . . .⁴

Tax Commission may have access to federal returns.—By following the procedure outlined in section 257 of the 1918 federal law, the state Tax Commission may have access to federal returns.

Section 257 reads, in part, as follows:

LAW. Section 257. That returns upon which the tax has been determined by the Commissioner shall constitute public records; but they shall be open to inspection only upon order of the President and under rules and regulations prescribed by the Secretary and approved by the President: *Provided*, That the proper officers of any State imposing an income tax may, upon the request of the governor thereof, have access to the returns of any corporation, or to an abstract thereof showing the name and income of the corporation, at such times and in such manner as the Secretary may prescribe. . . .

It should be noted that the foregoing section applies only to "any State imposing an income tax." Strictly speaking, the franchise tax is not an income tax, but is a tax which is based on net income for the privilege of doing business. Notwithstanding this fact, it is believed that the state of New York may have access to the federal returns, and that the courts would hesitate to restrain such an examination. In any event the President could issue an order, under the authority of this section, permitting officials of the state of New York to make such an examination.

[Former Procedure] The only effect of the amendment of 1920 on this section was to omit the following passage, contained in the law prior thereto:

"If the tax imposed upon any corporation under this article is based upon an estimate as provided in this section, the tax commission shall notify such corporation of a time and place at which opportunity will be given to the corporation to be heard in respect thereof. Such notice shall be mailed to the post-office address of the corporation."

When Changes and Corrections Are Made by the United States Treasury

The following procedure is prescribed when the United States Treasury makes any changes in the returns filed therewith.

Changes must be reported to Tax Commission within ten days.—

LAW. Section 219-d. If the amount of the net income for any year of any corporation taxable under this article as returned to the United States treasury department is changed or corrected by the commissioner of internal revenue or other officer of the United States or other competent authority, such corporation, within ten days after receipt of notice of such change or correction, shall make return under oath or affirmation to the tax commission of such changed or corrected net income, and shall concede the accuracy of such determination or state wherein it is erroneous. . . .

It should be noted that any changes made by the Treasury must be reported within ten days. In filing such a report, the corporation should be careful not to concede the accuracy of such change, if it intends to contest the findings of the Treasury.

Power of Tax Commission to reaudit and restate taxes.— Upon receipt of reports relative to federal returns the tax commission proceeds to reaudit and restate the tax.

LAW. Section 219-d. . . . The tax commission shall ascertain from such return and any other information in the possession of the commission, the entire net income of such corporation for the fiscal or calendar year for which such change or correction has been made by such commissioner of internal revenue or other officer or authority. All the authority conferred on the tax commission by the provisions of section one hundred and ninety-five of this chapter is hereby granted to it in respect to the ascertainment of such entire net income. The tax commission shall thereupon reaudit and restate the account of such corporation for taxes based upon the entire net income for such fiscal or calendar year, such reaudit to be according to the entire net income so ascertained by the tax commission. . . .

Credit is allowed if excessive tax has been paid.—

If from such reassessment it appears that such corporation shall

have paid under this article an excess of tax for the year for which such reassessment is made, the tax commission shall return a statement of the amount of such excess to the comptroller, who shall credit such corporation with such amount. Such credit may be assigned by the corporation in whose favor it is allowed to a corporation liable to pay taxes under this article, and the assignee of the whole or any part of such credit on filing with the commission such assignment shall thereupon be entitled to credit upon the books of the comptroller for the amount thereof on the current account for taxes of such assignee in the same way and with the same effect as though the credit had originally been allowed in favor of such assignee.

Additional tax must be paid within thirty days after notice.—

If from such reassessment it appears that an additional tax is due from such corporation for such year, such corporation shall, within thirty days after notice has been given as provided in section two hundred and nineteen-b of this chapter by the tax commission, pay such additional tax.⁵

Decisions of Tax Commission may be reviewed.—

. . . . The proceedings and determination of the tax commission in the making of such reassessment may be revised and readjusted and reviewed in the manner provided by sections two hundred and eighteen and two hundred and nineteen of this chapter, as in the case of an original assessment of the tax. . . .

Remedies Available to Taxpayer

If a corporation is dissatisfied with any assessment made by the Tax Commission, it should file an application for revision. This action is prerequisite to any court proceedings.

It would appear from a strict interpretation of the law that if upon appeal all or part of the assessment is sustained the 10 per cent penalty and interest at the rate of 1 per cent a month must be paid thereon. If this is a correct interpretation of the law taxpayers should pay the tax in all doubtful cases within thirty days of assessment and endeavor to secure a refund of any illegal or improper assessment.

⁵See page 487.

Application for revision may be filed within one year.—

LAW. Section 218. If an application for revision be filed with the commission by a corporation against which an account is audited and stated within one year from the time any such account shall have been audited and stated, the commission shall grant a hearing thereon and if it shall be made to appear upon any such hearing by evidence submitted to it or otherwise, that any such account included taxes or other charges which could not have been lawfully demanded, or that payment has been illegally made or exacted of any such account, the commission shall resettle the same according to law and the facts, and adjust the account for taxes accordingly, and may, in its discretion, modify the penalty imposed for failure to report as provided in this article, and shall send notice of its determination thereon to the corporation and state comptroller forthwith.

This and the following section of the law are similar to the provision in the personal income tax law, and, as in that case, fail to provide a time limit within which the Tax Commission must make its determination.⁶

Tax Commission's determination may be reviewed by writ of certiorari.—The procedure that should be followed to review the determination of the Tax Commission is set forth in the following section of the law.

LAW. Section 219. The determination of the commission upon any application made to it by any corporation for revision and resettlement of any account, as prescribed by this article, may be reviewed in the manner prescribed by and subject to the provisions of section one hundred and ninety-nine of this chapter.

No certiorari to review any audit and statement of an account or any determination by the commission under this article shall be granted unless notice of application therefor is made within thirty days after the service of the notice of such determination. Eight days' notice shall be given to the commission of the application for such writ. The full amount of the taxes, percentage, interest and other charges audited and stated in such account must be deposited with the state comptroller before making the application and an undertaking filed with the commission, in such amount and with such sureties as a justice of the supreme court shall approve, to the effect that if such writ is dismissed or the determination of the commission affirmed, the applicant for the writ will pay all costs and charges

⁶See page 108.

which may accrue against it in the prosecution of the writ, including costs of all appeals.

Section 199 of the tax law referred to above reads as follows:

The determination of the commission upon any application made to it by any person, partnership, company, association or corporation for a revision and resettlement of any account, as prescribed in this article, may be reviewed both upon the law and the facts upon certiorari by the supreme court at the instance of any person, partnership, company, association, or corporation affected thereby, and in the name and on behalf of the people of the state. For the purpose of such review the commission shall return, on such certiorari, the accounts and all the evidence before it on such application, and all the papers and proofs upon the original statement of such account and all proceedings thereon. If the original or resettled accounts shall be found erroneous or illegal, either in point of law or of fact, by the supreme court, upon any such review, the accounts reviewed shall then be corrected and restated, and from any determination of the supreme court upon any such review an appeal to the court of appeals may be taken by either party.

Method of Collection of Tax by the State

Unpaid taxes may be collected by levy.—

LAW. Section 219-e. If the tax imposed by this article be not paid within thirty days after the same becomes due, unless an appeal or other proceeding shall have been taken to review the same, the comptroller may issue a warrant under his hand and official seal directed to the sheriff of any county of the state commanding him to levy upon and sell the real and personal property of the corporation owning the same, found within his county, for the payment of the amount thereof, with the added penalties, interest and the cost of executing the warrant, and to return such warrant to the comptroller and pay to him the money collected by virtue thereof by a time to be therein specified, not less than sixty days from the date of the warrant. Such warrant shall be a lien upon and shall bind the real and personal property of the corporation against whom it is issued from the time an actual levy shall be made by virtue thereof. The sheriff to whom any such warrant shall be directed shall proceed upon the same in all respects, with like effect, and in the same manner as prescribed by law in respect to executions issued against property upon judgments of a court of record, and shall be entitled to the same fees for his services in executing the warrant, to be collected in the same manner.

Action may be brought to recover taxes and to forfeit charter.—

LAW. Section 219-f. Action may be brought at any time by the attorney-general at the instance of the comptroller, in the name of the state, to recover the amount of any taxes, penalties and interest due under this article. If such taxes be not paid within one year after the same be due, and the comptroller is satisfied that the failure to pay the same is intentional he shall so report to the attorney-general, who shall immediately bring an action in the name of the people of the state, for the forfeiture of the charter or franchise of any corporation failing to make such payment, and if it be found that such failure was intentional, judgment shall be rendered in each action for the forfeiture of such charter and for its dissolution if a domestic corporation and if a foreign corporation for the annulment of its franchise to do business in this state.

Statute of limitations does not apply to collection of taxes.—

LAW. Section 219-k. The provisions of the code of civil procedure relative to the limitation of time of enforcing a civil remedy shall not apply to any proceeding or action taken to levy, appraise, assess, determine or enforce the collection of any tax or penalty prescribed by this article.

Refunds and Credits

Excessive taxes paid should be refunded.—Prior to the 1920 amendment, section 219-j of the law contained the following provision:

Upon receipt of notice from the tax commission of any credit under this article the comptroller may refund to the corporation, out of the current revenues in his hands received under this article, the amount of such excess paid by the corporation, without interest, and shall charge the amount or amounts of such excess against the state treasury and the taxing district or districts in the proportions that such excess was originally credited or paid. In case the amount of current revenues credited to any taxing district under this article is not equal to the charge against any such taxing district on account of such refund, further revenues credited to such taxing district shall first be applied by the comptroller to the liquidation of such charge.

However, in the amendment this part of the section was deleted, as was the balance of the section with the ex-

ception of the following which now constitutes the whole section :

LAW. Section 219-j. After this article takes effect, corporations taxable thereunder shall not be assessed on any personal property, or on capital stock as provided for in section twelve of this chapter.

The language of this section prior to the amendment, as quoted above, was not mandatory, but it is inconceivable that the Comptroller will not refund any taxes illegally or erroneously collected.

In view of the decision by the court of appeals in the case of *Alpha Portland Cement Company v. Knapp et al.*⁷ it is probable that many corporations have paid to the state taxes which were assessed by the state Tax Commission without any warrant of law. The Tax Commission should certainly return such money to the taxpayers without placing unnecessary burdens upon them in the way of procedure, despite the mandatory provisions of section 218.⁸ Such provisions were not intended to preclude the Tax Commission from giving proper relief in a case of this kind.

Deposit of revenues collected.—

LAW. Section 219-g. The state comptroller shall deposit all taxes, interest and penalties collected under this article in responsible banks, banking houses or trust companies in the state which shall pay the highest rate of interest to the state for such deposit, to the credit of the state comptroller on account of the franchise tax. And every such bank, banking house or trust company shall execute and file in his office an undertaking to the state, in the sum, and with such sureties, as are required and approved by the comptroller, for the safe keeping and prompt payment on legal demand therefor of all such moneys held by or on deposit in such bank, banking house or trust company, with interest thereon on daily balances at such rate as the comptroller may fix. Every such undertaking shall have indorsed thereon, or annexed thereto, the approval of the attorney-general as to its form. The state comptroller shall on the first day of each month make a verified return to the state treasurer of all

⁷See Appendix B for decision.

⁸See page 492.

revenues received by him under this article during the preceding month, stating by whom and when paid, and shall credit himself with all payments made to county treasurers since his last previous return pursuant to section two hundred and nineteen-h of this chapter.

Disposition of revenues collected.—

LAW. Section 219-h. The state comptroller shall on or before the twenty-fifth day of each month pay into the state treasury to the credit of the general fund all interest and penalties and two-thirds of all taxes received by him under this article during the preceding calendar month, as appears from the return made by him to the state treasurer. The balance of all taxes collected and received by him under this article from any corporation, as appears from the return made by him to the state treasurer, shall, on or before the twenty-fifth day of April, July, October and January, for the quarter ending with the last day of the preceding month, be distributed and paid by him to the treasurers of the several counties of the state and disposed of by such treasurers, in accordance with the following rules:

1. If the corporation has no tangible personal property within the state, such payment shall be made to the county treasurer of the county in which is located the office at which its principal financial concerns within the state are transacted;

2. If the corporation has tangible personal property, as shown by its report pursuant to section two hundred and eleven, in but one city or town of the state, such payment shall be made to the county treasurer of the county in which such city or town is located;

3. If the corporation has tangible personal property in more than one city or town of the state, as shown by its report pursuant to section two hundred and eleven, such payment shall be made to the county treasurers of the counties in which such cities or towns are located in the proportion that the average monthly value of the tangible personal property of such corporation in the cities and towns of such county bears to the average monthly value of all its tangible personal property within the state;

4. In making such payment to a county treasurer, the state comptroller shall indicate the portion thereof to be credited to any city or town within the county on account of the location therein of its principal financial office or property as determined by the preceding subdivisions, and if such principal financial office or property is located in a village shall indicate the village in which it is located; if such principal financial office or property is located in a city or in a town outside of a village, the whole of such portion shall be paid to such city or town as hereinafter provided; if such principal finan-

cial office or property is located in a village, there shall be paid to such village as hereinafter provided such a part of the entire amount credited to the town as the entire amount of taxes raised by said village, or portion thereof in said town, during the preceding calendar year for village and town purposes bears to the aggregate amount so raised by the town and village during the preceding calendar year for town and village purposes.

5. As to any county wholly included within a city such payment shall be made to the chamberlain or other chief fiscal officer of such city and be paid into the general fund for city purposes;

6. As to any county not wholly included within a city the county treasurer shall within ten days after the receipt thereof pay to the chief fiscal officer of a city or to the chief fiscal officer of a village or to the supervisor of a town the portion of money received by him from the state comptroller to which such city, village or town is entitled, which shall be credited by such officer to general city, village or town purposes.

Secrecy required of officers—penalty for violation.—

LAW. Section 219-i. 1. Except in accordance with proper judicial order or as otherwise provided by law, it shall be unlawful for any tax commissioner, agent, clerk, or other officer or employee to divulge or make known in any manner the amount of income or any particulars set forth or disclosed in any report under this article. Nothing herein shall be construed to prohibit the publication of statistics so classified as to prevent the identification of particular reports and the items thereof, or the publication of delinquent lists showing the names of taxpayers who have failed to pay their taxes at the time and in the manner provided by section two hundred and nineteen-c together with any relevant information which in the opinion of the comptroller may assist in the collection of such delinquent taxes; or the inspection by the attorney-general or other legal representatives of the state of the report of any corporation which shall bring action to set aside or review the tax based thereon, or against whom an action or proceeding has been instituted in accordance with the provisions of sections two hundred and sixteen or two hundred and nineteen-f of this article.

Reports shall be preserved for three years, and thereafter until the state tax commission orders them to be destroyed.

2. Any offense against the foregoing provision shall be punished by a fine not exceeding one thousand dollars or by imprisonment not exceeding one year, or both, at the discretion of the court and if the offender be an officer or employee of the state he shall be dismissed from office and be incapable of holding any public office in this state for a period of five years thereafter,

APPENDICES

APPENDIX A

FORMS AND ILLUSTRATIONS

In the preparation of the illustrations which follow the author has had in mind the taxpayer who has already made up his federal return and is about to prepare his state return. Having already entered the various items of income and deductions in the federal return, the problem arises as to the treatment of the same items in the state return.

Comparative income statements.—In order to show clearly the relationship between the items in the federal return and those in the state return, the following statements are given, showing in the case of both a resident individual and a non-resident individual:

1. Details of income and deductions.
2. Whether the item is taxable or non-taxable, deductible or not deductible for federal purpose.
3. The schedule under which the item should be entered on the federal return.
4. Whether the item is taxable or non-taxable, deductible or not deductible on the state return.
5. The line where the item should be entered on the state return.
6. The page in this volume where treatment of the particular item is discussed.

As many points of difference between state and federal procedure have been introduced as could be conveniently stated, and a reconciliation is given of the resulting difference between the amount of net income reported to the federal government and that reported to the state.

In cases where the spaces on the return forms are not

sufficient to give the necessary details, the information is stated in supporting schedules.

Specimen returns.—The following specimen returns are reproduced herewith:

	PAGES
1. Individual, resident (long form 201).....	510-513
2. Individual, non-resident (form 203).....	519-522
3. Fiduciary carrying on business within and without the state and having resident and non-resident beneficiaries (form 205).....	526-529
4. Apportionment of income of estate or trust (form 205A).....	530-531
5. Partnership carrying on business within and without the state and having resident and non-resident members (form 204).....	535-538
6. Apportionment of partnership income (form 204A).....	539-540

Accompanying the returns are explanatory statements of the data entered in the returns, so that the taxpayer, by using these statements as a guide, will be able to determine how to treat the various items properly.

The following blank income tax returns are reproduced for reference:

FORM		PAGES
101 (revised)	Certificate of taxpayer claiming residence in the state of New York.....	541
102 (revised 1920)	Certificate of non-residence and claim for personal exemption. Report of tax withheld at source	542
102-A (revised 1920)	Instructions for the use of form 102 (revised 1920)	543
103	Return of tax withheld at source.....	544, 545
105	Return of information at source.....	546
105-A	Instructions for use of form 105.....	547
106	Annual summary and letter of transmittal...	548
110	Claim for refund.....	549
200	Short form of tax return for resident individuals	550-553
328	Schedule of sales of securities.....	554

The following blank franchise tax returns are reproduced for reference:

FORM		PAGES
3 IT	Franchise tax report.....	555-558
8 IT	Compromise of penalty.....	559
15	Affidavit of foreign corporation which has ceased to do business within the state.....	560
30 CT	Affidavit of domestic corporation which has ceased to do business within the state.....	561

RESIDENT RETURN

JOHN J. JONES, 100 FIRST PL., FLUSHING, L. I.

ITEMS OF INCOME	AMOUNT	FEDERAL		NEW YORK STATE		
		Taxable	Non-taxable	Schedule on form 1040	Taxable	Non-taxable
				form 1040		Item on form 201
						PAGE
1. Salary as partner (see explanation under 18)						
2. Fees, director New York Securities Com- pany	\$400.00	\$12,000.00		B		215
3. Interest on \$20,000 Victory 4¾ notes.....	950.00	400.00		B	\$950.00	41
4. Interest on Federal Farm Loan bonds (dis- tributable portion from estate of Vincent Brown)	400.00	950.00		I		
5. Interest on bonds on which investment tax has been paid.....			\$400.00			41
6. Interest on New York State bonds (\$90 from estate of Vincent Brown; \$128 from partnership of Smith, Brown and Jones) ..	102.00	102.00		G1	400.00	42
7. Interest on city of Toledo, Ohio bonds....	218.00				102.00	
8. Interest on partner's capital account (see explanation under 18)	80.00		218.00		218.00	41
9. Interest on note accrued prior to January 1, 1919, but received April 1, 1920.....			80.00		80.00	22 (a)
10. Interest on other bonds and bank deposits (\$1,800 from tax-free bonds)	40.00	5,000.00		G5		
11. Amount of tax by debtor corporation on tax- free covenant bonds.....	2,412.00	40.00		G1	40.00	233
12. Interest on Fourth 4¾ Liberty bonds (dis- tributive share received from partnership) of Smith, Brown and Jones (see explana- tion under 18)	36.00	2,412.00		F & G3	2,412.00	233
		36.00		G4	36.00	22 (b)
			765.00			
Carried forward.....	\$4,638.00	\$20,940.00	\$1,463.00		\$2,928.00	\$1,710.00

ITEMS OF INCOME

Brought forward.

13. Interest on Fourth 4¼ Liberty bonds received direct. For exemption purposes the amount distributed by partnership is added to this.
14. Cash dividends.
15. Dividends paid in Liberty bonds (at market value of Liberty bonds at date dividend made payable).
16. Dividends declared payable prior to January 1, 1919.
17. Income from personal service corporations during 1920 (which includes dividends \$7,600 and undistributed profits \$1,200).
18. Distributive share of profits of partnership of Smith, Brown and Jones, New York City. (The amount distributed under the federal law is different from the amount distributed under the New York State law due principally to the fact that valuations as of March 1, 1913, are used under the former for purposes of depreciation and to arrive at profits on sale of stocks, etc., whereas values as of January 1, 1919, are used under the latter. The federal partnership return distributes profits separately from salaries and interest. The New York State distributes as one item profits, salaries, and interest (column 5, schedule 4, form 204). In this illustration, therefore, for federal purposes the partner includes under "Salary" his salary as partner and

AMOUNT	FEDERAL		Schedule on form 1040	NEW YORK STATE		SEE PAGE
	Taxable	Non-taxable		Taxable	Non-taxable	
\$4,638.00	\$20,940.00	\$1,463.00		\$2,928.00	\$1,710.00	
3,060.00	212.50	2,847.50	I	3,060.00		41
420.00	420.00		H	420.00	23 (a)	249
87.00	87.00		H	87.00	23 (b)	254
14.00	14.00		H	14.00		251
8,800.00	8,800.00		C	7,600.00	1,200.00 23 (a)	252

under "Interest," the interest on his capital account, whereas under the state he includes under distributive share of partnership profits, the total salary, interest and profits. The detail of these is as follows:)

	Federal	State
Profits	\$105,531.40	\$106,443.60
Liberty bond interest.....	765.00	
Salary	12,000.00	12,000.00
Interest	5,000.00	5,000.00
	<u>\$123,296.40</u>	<u>\$123,443.60</u>

123,443.60 24 333

19. Distributive share of the income of the Estate of Vincent Brown, James E. Jerome, Fiduciary, 169 E. 69th St., New York City. (The amount distributed under the federal law is different from the amount distributed under the New York State law, due to the receipt of income non-taxable under the former but taxable under the later.)

18,722.41 24 359

20. Loss from garage business (see note under 18)

5,666.00 25 300

21. Income from rents (see note under 18)

12,927.00 26 246

22. Profit from sale of stock, March 1, 1913, value used for cost of stock acquired prior to that date for federal, January 1, 1919, value used for New York State.....

1,960.00 27 177

23. Profit from appreciation of stock disposed of as a gift.....

80.00 27 201

24. Profit from sale of land (see note under 18)

21,000.00 28 177

25. Pension from United States government....

300.00 225 225

26. Sale of Norfolk and Western rights.....

80.00 27 183

27. Collection account of bad debt written off in 1919.....

312.00 29 312

28. Total Income from Above Sources.....

\$190,178.01 \$178,524.01 \$11,654.00

	AMOUNT	FEDERAL		Schedule on Form 1040	NEW YORK STATE			SEE PAGE
		Allowable	Unallow- able		Allowable	Unallow- able	Item on Form 201	
DEDUCTIONS								
29.	Interest on indebtedness to carry New York State bonds.....	60.00			60.00		31 (a)	290
30.	Interest on personal indebtedness.....	720.00		K1	720.00		31 (a)	290
31.	Taxes on real property.....	560.00		K2	560 00		31 (b)	292
32.	New York State income tax.....	4,560.00		K2		4,560.00		292
33.	Contributions (personal \$8,000; proportion of partnership donations \$1,200; must not exceed 15% of net income without this deduction)							
34.	Dues to Chamber of Commerce.....	9,200.00		M	9,200.00		31 (d)	278
35.	Remuneration of bookkeeper.....	100.00		K	100.00		31 (e)	271
36.	Account written off (value July 6, 1917, date of originating transaction, \$740; value January 1, 1919, \$370)	1,200.00		K	1,200.00		31 (f)	266
37.	Tax on club dues \$20; tax on railroad tickets \$14; auto license \$15.....	740.00		K4	370.00	370.00	31 (f)	306
38.	Total Deductions.....	49.00		K2	49.00		31 (c)	294
		<u>\$17,189.00</u>	<u>\$60.00</u>		<u>\$12,259.00</u>	<u>\$4,930.00</u>	32	

	FEDERAL	NEW YORK
	STATE	STATE
	\$185,781.31	\$178,524.01
	17,129.00	12,259.00
	\$168,652.31	\$166,265.01

COMPUTATION OF TAX

Net income		\$168,652.31	\$166,265.01
Less: Dividends	\$420.00		
	87.00		
	14.00		
Taxable interest on Liberty bonds	212.50		
Personal exemption	950.00		
	2,000.00	3,683.50	2,200.00
		\$164,968.81	\$164,065.01

Normal tax on \$164,968.81	\$13,037.50		
Surtax on \$168,652.31	59,955.29		
Total tax	\$72,992.79		\$4,321.95

Less: Tax paid at source on tax-free bonds			
Income tax withheld by Great Britain on dividends	\$36.00		
	18.40	54.40	
Balance of tax due	\$72,938.39		\$4,321.95

* Personal exemption (death of child, August 12, 1920).

JOHN J. JONES

SCHEDULE OF INCOME NON-TAXABLE BY STATE, RECEIVED DURING CALENDAR YEAR 1920

1.	Interest on \$20,000 Victory 4¾ notes.....	\$ 950.00
2.	Interest on Federal Farm Loan bonds (from estate of Vincent Brown)	400.00
3.	Interest on bonds on which investment tax was paid.....	102.00
4.	Interest on New York State bonds (from estate of Vincent Brown and partnership of Smith, Brown and Jones).....	218.00
5.	Interest on note accrued prior to January 1, 1919.....	40.00
6.	Interest on Fourth 4¾ Liberty bonds.....	3,060.00
7.	Dividends declared payable to stockholder of record prior to January 1, 1919.....	14.00
8.	Undistributed profits of personal service corporation.....	1,200.00
9.	Difference between net income received from rents shown in federal return where cost is used for depreciation purposes, and in the state return where January 1, 1919, values are used. (This is merely an adjustment to reconcile with figure shown under amount column of illustration).....	210.00
10.	Difference between federal and state profit on stock (see note under 9).....	160.00
11.	Difference between federal and state profit on sale of land (see note under 9).....	5,000.00
12.	Pension from United States Government.....	300.00
Total non-taxable income		<u>\$11,654.00</u>

JOHN J. JONES

RECONCILIATION OF DIFFERENCES BETWEEN FEDERAL AND NEW YORK STATE TAX RETURNS FOR 1920

Net income reported to federal government..... \$168,652.31

Add:

Interest on City of Toledo Bonds.....	\$ 80.00	
Difference between amount of distributive share from partnership of Smith, Brown and Jones, taxable under federal and the amount taxable under state	912.20	
Difference between amount of distributive share of income of estate of Vincent Brown, taxable under federal and the amount taxable under state	209.00	
Amount of appreciation of stock disposed of as a gift	80.00	
New York State tax, allowable deduction for federal, unallowable for state.....	4,560.00	
Difference between original value and January 1, 1919, value of account written off.....	370.00	6,211.20

Deduct:

Interest on Victory 4¾ bonds, taxable federal and taxable state	\$ 950.00	
Interest on which investment tax has been paid, taxable federal, not taxable state....	102.00	
Interest accrued prior to January 1, 1919, taxable federal, not taxable state	40.00	
Liberty bond interest taxable under federal, not taxable under state	212.50	
Dividends declared payable prior to January 1, 1919, taxable under federal, but not under state	14.00	
Income from undistributed profits of personal service corporation, taxable under federal, but not under state	1,200.00	
Difference between loss from garage business as reported to federal and as reported to state due to January 1, 1919, values used for depreciation in latter	350.00	
Difference in income from rents as reported to federal and as reported to state, January 1, 1919, values being used for the latter for depreciation, etc.	210.00	
Difference in profit from sale of stock as reported to federal and state, January 1, 1919, values being used for the latter.....	160.00	
Difference in profit from the sale of land as reported to federal and to state, January 1, 1919, value being used for the latter.....	5,000.00	
Pension received from United States Government, taxable federal, not taxable state....	300.00	
Interest on indebtedness to carry New York State bonds, unallowable under federal, allow under state	60.00	5,730.00

Income reported to New York State..... \$166,265.01

NEW YORK STATE INCOME TAX

Return for the Calendar Year 1920 or
Fiscal Period

Begun X X X X X
and Ended X X X X X 1920

TAX RETURN FOR RESIDENT INDIVIDUALS [1920]

To be used by resident individuals engaged in business or professions (except as partners) and those whose entire income is NOT derived solely from salaries, interest and dividends, or from partnerships, estates and trusts.

Individuals whose only sources of income are salaries, wages, etc., interest and dividends, or from partnerships, estates and trusts, should use Short Form No. 200.

Nonresidents should use Form No. 203.

THIS RETURN MAY BE FILED AT ANY DISTRICT OFFICE OF THE NEW YORK STATE INCOME TAX BUREAU

IF THIS RETURN IS
FOR THE CALENDAR
YEAR 1920 FILE IT ON
OR BEFORE
APRIL 15, 1921.

If for a period other than
a calendar year file it on
or before the 15th day of
the fourth month follow-
ing the close of such
period.

Do not write in these spaces
PRINT NAME AND RESIDENCE ADDRESS PLAINLY BELOW

NAME John J. Jones
RESIDENCE ADDRESS 100 First Place
(No.) Flushing, L. I.
(City, Village, Post office and State)

Do not write in this space
Amount Paid

Cashier's stamp

No.

1. Did you file a return for 1919? Yes 2. If so, what address did you give on that return? Same as above
3. Did you, during 1920, pay to any individual, rent, salaries, wages, etc., or other fixed or determinable income of \$1000, or over? Yes { If so, secure Forms Nos. 105 and 106 from any district office and file a return of information.

Personal Exemptions—Report your status during the period covered by this return

4. Were you at any time during this period married and living with wife (or husband)? Yes 5. If not, were you the "head of a family" as defined in Instruction D? X X X X X
6. How many dependent persons under 18 years of age (or mentally or physically defective) received their chief support from you during the year? One 7. What is the relationship to you of the dependent persons for whose support you claim exemption under Questions 5 and 6? daughter

8. Did (or will) your wife (or husband) or any of your dependent minor children make a separate return? No { If so, give name and address thereon.
9. If not, is the taxable income of your wife (or husband) and dependent minor children included in this return? Yes

10. Enter here all NON-TAXABLE INCOME received by (or accrued to) you or your wife (or husband) or any of your dependents, during the taxable year 1920. Exclude income of those filing separate returns. See Instruction E for non-taxable income.

See attached Schedule

11. Did you (or will you) file an income tax return for the period covered by this return with a U. S. Collector of Internal Revenue? Yes 12. If so, what amount of Total Net Income did you (or will you) report? \$ 168,652.31
13. If the total net income reported on the U. S. return differs from the amount of Item 33 of this return, give principal items of difference, or, if you prefer, attach a statement reconciling all differences.

See attached Schedule.

CALCULATION OF TAX

	Amount of Income Taxable at each Rate	Rate of Tax	Amount of Tax
14. Net income as shown by Item 33 (Page 2 of Return)	166265.01		
	\$10000.00	17. 1% on first \$10,000 of Item 16.	\$ 100.00
15. Less personal exemptions	2200.00	18. 2% on next \$40,000 of Item 16.	800.00
	114065.01	19. 3% on amount over \$50,000 of Item 16.	3,421.95
16. Balance SUBJECT TO TAX (Item 14 minus Item 15)	164065.01	20. TOTAL	\$ 4,321.95

THE TAX MUST BE PAID IN FULL ON FILING RETURN
Make checks payable to COMPTROLLER OF THE STATE OF NEW YORK

AFFIDAVIT

STATE OF NEW YORK—COUNTY OF _____ ss:

I swear (or affirm) that to the best of my knowledge and belief, the statements contained in this return including the accompanying schedules and statements (if any) are true, and that this return is a true and complete statement, in accordance with the law and regulations, of all income, gains and profits received by or accrued to me (or the person for whom this return is made) during the taxable year 1920, and that all deductions entered or claimed herein are allowable under the law and regulations.

Sworn to and subscribed before me this _____ day of _____, 1921.

(Signature of officer administering oath)

(Title)

(Signature of individual or agent)

(Address of agent)

[1920]

Long Form No. 201—Page 2 of Return
RETURN OF TAXABLE INCOME

(Include income of wife (or husband) and dependent minor children unless reported in separate returns.)

21. INCOME FROM PERSONAL SERVICES (Salaries, Fees, Commissions, Bonuses, etc.)

(a) OCCUPATION OR TRADE	(b) NAME AND ADDRESS OF EMPLOYER	AMOUNT
Feen, as director	New York Securities Company	\$ 400.00

Show the report amount received (or due) only if deductions therefrom are claimed; report from under Item 21, and do not include compensation paid by the United States, see instructions 21.

22. INCOME FROM INTEREST

Report interest received (or accrued) and deductible without limitation of amount (including state bonds when their maturity is not more than 1 year from the date of purchase) and include assets interest for which no limitation is shown.

Salary to self and dependent minor children included in any deduction in Item 25		
(a) Interest (bonds or other corporate obligations; bank deposits, notes, etc.)		\$ 2,492.00
(b) Amount of tax paid for taxpayer by debtor corporation on tax-free government bonds		36.00

23. INCOME FROM DIVIDENDS

Report the value of dividends received other than in cash.

(a) Received in cash		\$ 8,020.00
(b) Received in property (other than true stock dividends; liberty bonds at market value date dividend made payable)		87.00

24. INCOME FROM PARTNERSHIPS, ESTATES AND TRUSTS

Report your entire share (whether distributed or not) in the profits of the partnership (including salary and interest) or the income of the estate or trust, not merely the amount withdrawn by or paid to you.

(a) Smith, Brown & Jones, New York City		\$23,443.60
(b) Estate of Vincent Brown, James E. Jerome, Fiduciary, 169 E. 69 St., N.Y.C.		18,722.41

25. INCOME FROM BUSINESS OR PROFESSION (Including Farming)

(a) Kind of business, Garage

(c) State whether this statement of business income is on a cash or an accrual basis. Accrual

(d) If inventories are used, state whether they are valued (a) at cost or (b) at cost or market, whichever is lower. Cost

Shoppers may submit statements attached hereto, in the form in which their books are kept, giving no less details than called for herein, and enter the net income for Item 25 below.

(e) TOTAL SALES AND INCOME FROM BUSINESS OR PROFESSIONAL SERVICES

COST OF GOODS SOLD:

(f) Labor	\$ 8,400.00	(g) Salaries and wages paid to employees (Cost of Goods Sold)	\$ 4,400.00
(g) Materials and supplies	11,680.00	(h) Interest on business indebtedness to others	450.00
(h) Merchandise purchased		(i) Taxes on business and business property	980.00
(i) Other costs	875.00	(j) Depreciation (explain in Schedule B—Page 2 of return)	926.00
(j) Plus inventories at beginning of year	1,980.00	(k) Losses not compensated by insurance (explain in Schedule C—Page 3 of return)	2,000.00
(k) Total	\$22,935.00	(l) Bad debts (explain in Schedule C—Page 3 of return)	250.00
(l) Less inventories at end of year	2,260.00	(m) Other expenses (give principal items in Schedule C)	775.00
(m) Cost of Goods Sold (k minus l)	\$20,675.00	(n) TOTAL OTHER BUSINESS DEDUCTIONS	\$ 9,791.00

(w) Cost of Goods Sold Plus Total Other Business Deductions (Item m plus Item n)

(x) NET INCOME FROM BUSINESS OR PROFESSION (Item e minus Item w) (If net loss, enter in red ink and subtract)

\$ 30,466.00

\$ 5,668.00

26. INCOME FROM RENTS AND ROYALTIES (See Instruction 26)

(a) KIND OF PROPERTY	(b) LOCATION	(c) GROSS AMOUNT OF RENTS AND ROYALTIES	(d) REPAIRS, DEPRECIATION AND EXHAUSTION (Explain in Schedule B-Page 5)	(e) INTEREST	(f) TAXES	(g) OTHER EXPENSES (Give principal details in Schedule C-Page 5)
Apartment	4 W 109 St., N.Y.C.	\$7600.00	\$7208.00	\$15400.00	\$7750.00	\$14525.00
(h) Net Income from Rents and Royalties (Column e less total of Columns d, e, f and g) (If net loss enter in red ink and subline) If there was more than one sale or exchange during the year, submit separate statement in similar form for each sale and enter net profit (or loss) on Item K below						
27. PROFIT (OR LOSS) FROM SALE, EXCHANGE OR GIFT OF STOCKS AND BONDS (Not dealt in as a business and not included in Item 25)						
(a) Sale Price (or Fair Market Value of Property Received in Exchange)						
Less: (b) As to securities acquired Prior to January 1, 1919, their fair market value on January 1, 1919						
(c) As to securities acquired After January 1, 1919, their cost to you						
(d) Profit on Loss from Sale, Exchange or Gift of Stocks and Bonds (Item a minus total of Items b and c) (If net loss, enter in red ink and subline)						
28. PROFIT (OR LOSS) FROM SALE, EXCHANGE OR GIFT OF LANDS, BUILDINGS AND OTHER PROPERTY (Not dealt in as a business and not included in Items 25 or 27) See Instruction 28						
(a) Kind of property: Land						
(b) Location: Gary, Indiana						
(c) Year acquired: 1904						
(d) Original cost: \$22,000						
(e) Sale Price (or Fair Market Value of Property Received in Exchange)						
(f) Fair market value on January 1, 1919, (or cost if acquired thereafter) of property sold or exchanged						
(g) Cost of permanent improvements, if any, after January 1, 1919, or after date of purchase, if acquired since						
(h) Total (Item f plus Item g)						
(i) Deduct depreciation after January 1, 1919, or after date of purchase if acquired since						
(j) Difference (Item h minus Item i)						
(k) Net Profit on Sale, Exchange on Gift of Lands, Buildings, etc. (Item e minus Item j). (If net loss, enter in red ink and subline)						
29. OTHER INCOME (Describe each source separately and in full)						
(a) Sale of Norfolk and Western rights						
(b) Collection on account of bad debts written off in 1919						
(c) Do not report exempt income here.						
30. TOTAL INCOME FROM ABOVE SOURCES (Items 21 to 29 inclusive)						
31. DEDUCTIONS not claimed above						
(a) Interest on personal indebtedness						
(b) Taxes upon real property (except assessments for local benefits) not deducted in Items 28 (g) or 29 (i)						
(c) Other taxes (except income taxes). State character and amount of each in Schedule C.						
(d) Contributions (Submit details on Schedule A—page 3 of return) (See Instruction 31d).						
OTHER DEDUCTIONS (Describe each separately and in full)						
(e) dues to Chamber of Commerce \$100.00. Remuneration of bookkeeper \$1,200						
(f) Accounts written off (Value, January 1, 1919)						
32. NET INCOME (Item 30 minus Item 31)						
33. NET INCOME (Item 30 minus Item 32) Enter on page 1, Item 14.						

SCHEDULE A - Statement of Contributions to Charitable, Religious, Scientific and Educational Corporations and Associations claimed as deductions in Item 31 (d) - Page 2 of Return. (This deduction must not exceed 15% of the amount of Item 33 plus Item 31 (d).)

1.	2.	3.	4.
NAME OF ORGANIZATION	AMOUNT	NAME OF ORGANIZATION	AMOUNT
Red Cross	2,000 00		
Yale College	5,000 00		
Y.M.C.A.	1,000 00		
Proportion of Donations made by partnership of Smith, Brown & Jones	1,200 00		
	9,200 00		

SCHEDULE B - Statement of Deductions claimed for repairs, depreciation and depletion in Items 25 (r) and 26 (d) - Page 2 of Return

1. REFER TO ITEM 25 (r) OR 26 (d)	2. KIND OF PROPERTY (Principal material of which constructed)	3. LOCATION No. Street or Avenue City	4. YEAR ACQUIRED & CONTINUED	5. COST OR VALUE ON JAN. 1, 1919, IF ACQUIRED PRIOR TO 1919 (Carry over from 1919)	6. DEPRECIATION OR DEPLETION CHARGED OFF SINCE JANUARY 1, 1919	7. AMOUNT THIS YEAR	8. INCIDENTAL REPAIRS NOT DEDUCTIBLE IN PREVIOUS YEARS DEDUCTIONS	9. AMOUNT
25(r)	Garage (Concrete)	372 E. 130 St. N.Y. City	1917	\$40,000.00	2	800 00	800 00	126 00
26(d)	Apartment (stone)	4 W. 109 St. N.Y. City	1/2/20	320,000.00	2	None	6,400 00	808 00
	TOTALS			\$360,000.00		\$800.00	7,200 00	934 00

SCHEDULE C - Explanation of Deductions claimed in Items 25 (s), 26 (t), 25 (u), 26 (v) and 31 (c) - Page 2 of Return

1. REFER TO ITEM NO.	2. EXPLANATION	3. AMOUNT	4. REFER TO ITEM NO.	5. EXPLANATION	6. AMOUNT
25(s)	Elevator accident not covered by insurance	\$2000 00	26(g)	Insurance, Light & Heat	3400 00
25(t)	Depts. A.T. Jones 360; R.O'Brien 90	250 00		Commission rental agent	4600 00
25(u)	Insurance	114 00		Supt., Janitor, Elevator Man.	5100 00
	Light & Heat	278 00		Miscellaneous	1425 00
	Stationery & Store Supplies	118 00		Tax on club dues \$20.00 Tax on R.R. tickets \$14.00	34 00
	Miscellaneous	265 00		Auto License	15 00
		775 00			\$49 00

Did you employ any person especially to prepare this return? If so, give name and address.

NON-RESIDENT RETURN

GEORGE V. BROWN, 109 MAIN ST., NEWARK, N. J.

ITEMS OF INCOME	AMOUNT	FEDERAL		NEW YORK STATE		SEE PAGE		
		Taxable	Non-taxable	Schedule on form 1040	Taxable		Non-taxable	Item on form 203
1. Salary as partner Smith, Brown and Jones. (As salary is considered a distribution of profits, the amount received for the year 1920 is distributed to the non-resident partner on the basis of net income of the partnership allocated to New York, i.e., 74.713%								
2. Fees as director, New York Trust Company	\$14,000.00	\$14,000.00		B	\$10,459.82	\$3,540.18	19	391
3. Distributive share of profits of Smith, Brown and Jones, New York City. (The difference between the amount included in federal income and New York State income is due to the fact that for the former, values of March 1, 1913, are used for depreciation purposes and to arrive at amount of profit on sale of assets, whereas for the latter January 1, 1919, values are used; as well as sundry other differences between the taxable income as defined by both laws. In addition, the partnership having done business both within and without the state of New York, the non-resident partner reports only his distributive share of the income allocated to New York. See also form 204A.)	200.00	200.00		B	200.00		19	215
	79,148.55	79,148.55		C	59,960.84	19,187.71	20	391

4. Distributive share of the income of the estate of Vincent Brown, James E. Jerome, Fiduciary, 169 E. 69th St., New York City. (The amount distributed under the federal law is different from the amount distributed under the state, due to the receipt of income not taxable under the former, but taxable under the latter. In addition, George V. Brown being a non-resident includes in his state return his distributive share of the income of the estate allocated to New York State.)
5. Income from retail shoe stores located at 412 E. 125th St., New York City, and Market St., Newark, N. J. (Total income of the business started in 1919 is reported for federal tax. For New York State, only the percentage thereof that the business carried on in New York bears to the total business, i.e., 61.777%, is reported. See schedule G, form 203.)
6. Income from rents. (Difference due to the fact that for the federal returns, values as of March 1, 1913, are used for depreciation purposes, whereas for New York State, January 1, 1919, values are used. Income from rents amounting to \$1,200 was also received from property without New York State.)
7. Profit from sales of stock
8. Profit from gift of house at 451 W. 157th St., New York City, given away January 2, 1920

	18,513.42	18,513.42	C	13,570.57	4,942.85	20	393
	11,746.00	11,746.00	A	7,256.33	4,489.67	21	394
	2,400.00	2,400.00	E	1,044.00	1,355.00	22	206
	2,200.00	2,200.00	D		2,200.00		177
	1,112.00	1,112.00		1,112.00		23	201
	\$129,319.97	\$128,207.97		\$93,603.56	\$35,716.41		

Carried forward.

ITEMS OF INCOME

ITEMS OF INCOME	AMOUNT	FEDERAL		NEW YORK STATE		SEE PAGE
		Taxable	Non-taxable	Taxable	Non-taxable	
			Schedule on form 1040	Item on form 201		
<i>Brought forward</i>	\$129,319.97	\$128,207.97	\$1,112.00	\$93,603.56	\$35,716.41	
9. Loss on sale of apartment, 202 W. 105th St., New York City. (Difference due to the fact that March 1, 1913, value was used for federal return and January 1, 1919, for New York State, as well as a loss of \$2,820 on sale of real property situated without New York State.).....	4,960.00	4,960.00	D	1,860.00	3,100.00	23
10. Interest on partner's capital account. (Considered a distribution of profits for New York State. See note under 1.).....	5,000.00	5,000.00	G5	3,735.65	1,264.35	24
11. Interest on Fourth 4¼ Liberty bonds. (Distributive share received from partnership of Smith, Brown and Jones.).....	573.75				573.75	41
Interest on Fourth 4¼ Liberty bonds received direct. (For exemption purposes the amount distributed by partnership is added to this.).....	212.50				212.50	41
12. Interest on \$15,000 War Finance Corporation 5% bonds.....	750.00	500.00	I		750.00	41
13. Interest on \$10,000 Victory Fourth 3¼ Liberty bonds.....	475.00	475.00	I		475.00	41
14. Interest on bonds on which the investment tax has been paid.....	40.00	40.00	G1		40.00	42
15. Interest on Federal Farm Loan bonds. (Distributable portion from estate of Vincent Brown.).....	400.00				400.00	41
16. Interest on bonds, bank deposits, etc.....	412.00	412.00	G1 & 3		412.00	233
17. Tax paid on tax-free covenant bonds.....	4.00	4.00	G4		4.00	240
18. Interest on state of Pennsylvania bonds.....	220.00				220.00	42
19. Interest on New York State bonds. (\$90 from estate of Vincent Brown, \$96 from partnership of Smith, Brown and Jones.)	186.00				186.00	41
20. Cash dividends.....	320.00	320.00	H		320.00	249

21.	Dividends paid in stock of a corporation other than the corporation paying the dividend. (Valued as of the date dividend was payable.)	140.00	H	140.00	254
22.	Income from personal service corporation during 1920. (Dividends paid during 1920, \$12,000, undistributed profits during 1920, \$2,400.)	14,400.00 280.00	C B	14,400.00 280.00	252 374
23.	Pension from United States government....				
24.	Total Income from above sources....	<u>\$147,773.22</u>	J	<u>\$95,479.21</u> <u>\$52,294.01</u>	
DEDUCTIONS		AMOUNT	FEDERAL	NEW YORK STATE	
		Allowable	Unallow- able	Allowable	Unallow- able
25.	Interest on indebtedness to carry city of Cohoes, N. Y., bonds.....	\$480.00	\$480.00		\$480.00
26.	Interest on personal indebtedness.....	360.00			360.00
27.	Taxes on real property situated without the state	700.00			700.00
28.	New York State income tax.....	1,420.00			1,420.00
29.	Contributions. (\$2,000 to corporations incorporated or organized under the laws of the state of New York and including \$900, being distributable share of contributions made by partnership of Smith, Brown and Jones and \$4,000 to corporations organized outside New York State.)	6,000.00 100.00			
30.	Dues to New York Merchants Association..	500.00			
31.	Accountants' fees	350.00			
32.	Personal bad debt written off				
	Total Deductions.....	<u>\$9,910.00</u>	<u>\$9,430.00</u>	<u>\$2,600.00</u>	<u>\$7,310.00</u>
					27

NEW YORK
STATE

FEDERAL

\$144,818.97
9,430.00

Total income as above, item 24.....
Less: Total deductions, item 33.....

Net income

\$92,879.21
\$92,879.21

COMPUTATION OF TAX

Net income
Less: Dividends

\$135,388.97

5188

Taxable interest on Victory bonds.....
Taxable interest on War Finance bonds.....
Personal exemption

\$320.00
140.00
475.00
500.00
2,000.00

3,435.00

\$131,953.97
\$90,879.21

Normal tax on \$131,953.97.....
Surtax on \$135,388.97.....

\$ 10,396.32
41,912.26

Total tax
Less: Paid at source.....

\$ 52,308.58
4.00

Balance tax due

\$ 2,126.38
\$ 2,126.38

[1920]

NEW YORK STATE INCOME TAX—NONRESIDENT RETURN

For the Calendar Year 1920

or Fiscal Period, begun x x x x x x and ended x x x x x x 1920

To be used by individuals, NOT residents of the State of New York, deriving income from:

- (a) property situated within the State of New York;
 (b) a business, trade, profession or occupation carried on within the State of New York;
 (c) services rendered within the State of New York.

See Instruction A for definition of "resident" and "nonresident."

THIS RETURN MAY BE FILED AT ANY OFFICE OF THE NEW YORK STATE INCOME TAX BUREAU

IF THIS RETURN IS
FOR THE CALENDAR
YEAR 1920 FILE IT ON
OR BEFORE
APRIL 15, 1921.

Do not write in these spaces

Do not write in these spaces
Amount Paid

PRINT NAME AND RESIDENCE ADDRESS PLAINLY BELOW

NAME

George V. Brown

(First name in full—middle initial—last name in full)

RESIDENCE ADDRESS

109 Main Street

(No.)

(Street or avenue or rural route)

Newark, N. J.

(City, Village, Post office and State)

Cashier's stamp

No.

If for a period other than
a calendar year file it on
or before the 15th day
of the fourth month
following the close of
such period.

1. Did you file a return for 1919? Yes 2. If so, what address did you give on that return? Same as above

Personal Exemptions—Report your status during the period covered by this return

3. Were you at any time during this period married and living with wife (or husband)? Yes4. If not, were you the "head of a family" as defined in Instruction F? x x x x

5. How many dependent persons under 18 years of age (or mentally or physically defective) received their chief support from you during the year? None

6. What is the relationship to you of the dependent persons for whose support you claim exemption under Questions 3 and 5? x x x x

7. Did (or will) your wife (or husband) or any of your dependent minor children make a separate return? (If so, give name and address thereof) No

8. If not, is the taxable income of your wife (or husband) and dependent minor children included in this return? Yes
 Note.—If your wife (or husband) or dependent minor children derived any income from sources within the State of New York, it must be included in this or in a separate return.

CALCULATION OF TAX

9. Net income shown by Item 28, Page 2 of Return.....	\$2879.21
10. Less personal exemption (See Instruction F).....	2000.00
11. BALANCE SUBJECT TO TAX.....	\$90879.21

Amount of income taxable at each rate	Rate of Tax	Amount of tax	If any tax has been withheld at source from your compensation, fill in this column.	Amount
\$10000.00	12. 1% on first \$10,000 of Item 11	\$100.00	16. Total tax (Item 15).....	\$2,126.38
40000.00	13. 2% on next \$40,000 of Item 11	800.00	17. Less Tax withheld at source (Item 19c).....	
40879.21	14. 3% on amount over \$50,000 of Item 11.....	1,226.38	18. Balance due (Item 16 minus Item 17)*.....	\$2,126.38
\$90879.21	15. TOTAL.....	\$2,126.38		

*If Item 17 exceeds Item 16 on account of withholding at the source an amount in excess of Item 15, this return will be considered as a claim for refund. No other or further claim need be filed.

The tax due must be paid IN FULL on filing return.

Make Checks Payable to COMPTROLLER OF THE STATE OF NEW YORK

AFFIDAVIT

STATE OF _____ COUNTY OF _____, ss.:

I swear (or affirm) that to the best of my knowledge and belief, the statements contained in this return including the accompanying schedules and statements (if any) are true, and that this return is a true and complete statement, in accordance with the law and regulations, of all income, gains and profits received by or accrued to me (or the person for whom this return is made) during the taxable year 1920, from sources within the State of New York, and that all deductions entered or claimed herein are allowable under the law and regulations.

Sworn to and subscribed before me this _____ day
 of _____, 1921.

(Signature of individual or agent)

(Signature of officer administering oath)

(Title)

(Address of agent)

Seal not required

[1920]

RETURN OF TAXABLE INCOME OF NONRESIDENT INDIVIDUAL FROM SOURCES WITHIN THE STATE OF NEW YORK

19. INCOME FROM PERSONAL SERVICES (Salaries, Wages, Fees, Commissions, Bonuses, etc.)

Show the gross amount received or accrued, if deductions therefrom are claimed, report them under Item 25.

If you received compensation for services rendered partly within and partly without the State, explain in Schedule D, page 4 of return, the basis on which you apportion your income.

Do not include compensation received as officer or employee of the United States.

(a) OCCUPATION	(b) NAME AND ADDRESS OF EMPLOYER	(c) AMOUNT OF TAX WITHHELD
Partner	Smith, Brown & Jones 871 Broadway, NYC	None
Director's	N.Y. Trust Company	

AMOUNT OF INCOME FROM SOURCES WITHIN THE STATE OF NEW YORK	
\$ 10,459	82
200	00

20. INCOME FROM PARTNERSHIPS, ESTATES AND TRUSTS

If apportionment is required, apportion on the basis shown in the return of the partnership or fiduciary.

Give name and address of partnership, estate or trust. If estate or trust, give also name and address of fiduciary.

(a) Smith, Brown & Jones, N.Y.C. & Newark	\$ 59,960	84
(b) Estate of Vincent Brown, James Jerome, Fiduciary, 169 E. 69 St., N.Y. City	13,570	57
Net income from business or profession, as per Schedule A	\$ 7,256	33

21. INCOME FROM BUSINESS OR PROFESSION (Including Farming)

Enter nothing until Schedule A is filled in; then enter here the amount of Item 80 of Schedule A unless the business is carried on partly within and partly without the State, in which case Schedules K and Q must first be made out and the percentage of Item 80 of Schedule A indicated on line 9 of Schedule Q entered here.

Net income from business or profession, as per Schedule A

22. INCOME FROM RENTS AND ROYALTIES From Property Situated Within the State of New York

(a) KIND OF PROPERTY AND LOCATION	(b) GROSS AMOUNT OF RENTS AND ROYALTIES	(c) REPAIRS, DEPRECIATION AND DEPLETION (explain in Schedule B)	(d) TAXES	(e) INTEREST AND OTHER EXPENSES (explain principal items in Schedule C)	
Apartment, 202 W. 105 St. N.Y.C.	\$9,600 00	\$ 1,468 00	\$ 1,125 00	\$ 5,963 00	
(f) NET INCOME FROM RENTS AND ROYALTIES (Column b, less total of columns c, d and e. If net loss, enter in red ink and subtract.)	\$9,600 00	\$ 1,468 00	\$ 1,125 00	\$ 5,963 00	1,044 00

23. PROFIT (OR LOSS) FROM SALE, EXCHANGE OR GIFT OF LANDS, BUILDINGS AND OTHER PROPERTY SITUATED IN NEW YORK STATE (Not dealt in as a business)

If there was more than one sale, exchange or gift during the year, submit separate statement in similar form for each sale and enter total net profit (or net loss) on Item k below.

(a) Kind of property and location	Apartment, 202 W. 105 St. N.Y. City				
(b) Sold, exchanged or given away?	Date	Original			
	acquired	cost	\$ 93,000		
(c) SALE PRICE OR VALUE OF GIFT (OR FAIR MARKET VALUE OF PROPERTY RECEIVED IN EXCHANGE)			\$86,000 00		
(f) Fair market value on January 1, 1919 (or cost if acquired thereafter) of property sold or exchanged			\$92,000		
(g) Cost of permanent improvements, if any, after January 1, 1919, or after date of purchase, if acquired since					
(h) TOTAL (Item f plus Item g)			\$92,000		
(i) Deduct depreciation after January 1, 1919, or after date of purchase if acquired since			4,140		
(j) DIFFERENCE (Item h minus Item i)			\$87,860 00		
(k) NET PROFIT ON SALE, EXCHANGE OR GIFT OF LANDS, BUILDINGS, ETC. (Item c minus Item j). (If net loss, enter in red ink and subtract)					\$ 1,860 00

23. PROFIT (OR LOSS) FROM SALE, EXCHANGE OR GIFT OF LANDS, BUILDINGS AND OTHER PROPERTY SITUATED IN NEW YORK STATE (Not dealt in as a business)

If there was more than one sale, exchange or gift during the year, submit separate statement in similar form for each sale and enter total net profit (or net loss) on Item k below.

(a) Kind of property and location	Residence, 451 W. 157 St. N.Y. City				
(b) Sold, exchanged or given away?	Date	Original			
	acquired	cost	\$ 22,000 00		
(c) SALE PRICE OR VALUE OF GIFT (OR FAIR MARKET VALUE OF PROPERTY RECEIVED IN EXCHANGE)			\$22,672 00		
(f) Fair market value on January 1, 1919 (or cost if acquired thereafter) of property sold or exchanged			\$22,000		
(g) Cost of permanent improvements, if any, after January 1, 1919, or after date of purchase, if acquired since					
(h) TOTAL (Item f plus Item g)			\$22,000		
(i) Deduct depreciation after January 1, 1919, or after date of purchase if acquired since			440		
(j) DIFFERENCE (Item h minus Item i)			\$21,560 00		
(k) NET PROFIT ON SALE, EXCHANGE OR GIFT OF LANDS, BUILDINGS, ETC. (Item c minus Item j). (If net loss, enter in red ink and subtract)					1,112 00

24. OTHER INCOME From Sources Within the State of New York (Describe each source separately and in full)

Explain in Schedule D, page 4 of return, apportionment, if any is made, in the case of New York income from any source, both within and without the State.

(a) Interest on partner's capital account	\$ 3,735	65
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25. TOTAL INCOME FROM ABOVE SOURCES (Items 10 to 24 inclusive)

\$ 95,479 21

26. DEDUCTIONS not claimed above

See Instruction #8.

Deductions allowable to a nonresident are limited to expenses incurred in connection with the production of taxable income from sources within the State and losses from business carried on or property owned within the State.

(a) Interest on indebtedness		
(b) Taxes		
(c) Contributions (Submit details in Schedule E on page 4 of return) (See Instruction 28c)	2,000	00
OTHER DEDUCTIONS (Describe each separately and in full)		
(d) Dues to N.Y. Merchants Assn.	100	00
(e) Accountants fees	500	00

27. TOTAL DEDUCTIONS \$ 2,600 00

28. NET INCOME (Item 25 minus Item 27) Enter on line 1 Item 9

SCHEDULE A**Income from business or profession carried on wholly or partly within the State of New York**

If the business is carried on both within and without the State (as defined in the regulations) report the total income from the business, and exhibit apportionment in Schedule G.

1. Kind of business Retail Shoe Store
2. State whether this statement of business income is on a cash or an accrual basis Accrual
3. If inventories are used, state whether they are valued (a) at cost or (b) at cost or market, whichever is lower Cost or market value,
Taxpayers may submit statements attached hereto, in the form in which their books are kept, giving no less details than called for herein, and enter the net income (or loss) below, whichever is lower
- TRADING OR OPERATING INCOME**
4. TOTAL SALES AND INCOME FROM BUSINESS OR PROFESSIONAL SERVICES \$240,000.00

COST OF GOODS SOLD:		OTHER BUSINESS DEDUCTIONS:	
5. Labor	\$	13. Salaries and wages not reported under "Cost of Goods Sold"	\$14,400.00
6. Materials and supplies		14. Rent for business property	8,000.00
7. Merchandise purchased	200,000.00	15. Interest on business indebtedness to others	412.00
8. Other costs	1,200.00	16. Taxes on business and business property	
9. Plus inventories at beginning of year	8,600.00	17. Repairs, depreciation and depletion (explain in Schedule D—below)	1,552.00
10. TOTAL	209,800.00	18. Losses not compensated by insurance (explain in Schedule C—below)	
11. Less inventories at end of year	7,400.00	19. Bad debts (explain in Schedule C—below)	
12. Cost of Goods Sold (Item 10 minus Item 11)	202,400.00	20. Other expenses (explain principal items in Schedule C—below)	3,230.00
21. TOTAL OTHER BUSINESS DEDUCTIONS			27,594.00
22. Cost of Goods Sold PLUS TOTAL OTHER BUSINESS DEDUCTIONS (Item 12 plus Item 21)			229,994.00
23. NET TRADING OR OPERATING INCOME FROM BUSINESS OR PROFESSION (Item 4 minus Item 22)			\$ 10,006.00
NON-OPERATING INCOME OF THE BUSINESS OR PROFESSION			
<i>Do not include income from rents, or profits from the sale of lands and other property (not dealt in as a business) which must be reported on page 8 of Return in Items 28 and 29.</i>			
24. Interest			\$ 320.00
25. Dividends from stocks carried as business assets			120.00
26. Profit from the sale of stocks and bonds, not dealt in as a business, but carried as business assets			1,300.00
27.			
28.			
29.			
30. TOTAL NET INCOME FROM BUSINESS OR PROFESSION			\$ 11,746.00

If you carry on business (as defined in the regulations) only within the State of New York, enter the amount of Item 30 of Schedule A, in Item 21 on page 2 of return.

If you carry on business (as defined in the regulations) both within and without the State of New York, fill in Schedules F and G on page 4 of return and enter in Item 21 on page 2 of return, the proportion of your income allocated to the State of New York.

SCHEDULE B

Statement of deductions claimed for repairs, depreciation and depletion in Item 17 of Schedule A, and Item 22(c) on page 2 of return

1.	2.	3.	4.	DEPRECIATION AND DEPLETION CHARGED OFF SINCE JANUARY 1, 1919			8.
REFER TO ITEM NO.	KIND OF PROPERTY (Principal material of which constructed) AND LOCATION	YEAR ACQUIRED	VALUE ON JAN. 1, 1919. (OR COST IF ACQUIRED THEREAFTER) (Explain in Item 17)	5.	6.	7.	INCIDENTAL REPAIRS NOT INCLUDED IN DEPRECIATION DEDUCTIONS
				RATE	AMOUNT IN 1919	AMOUNT THIS YEAR	
22(c)	Apartment (Brick) 202 W. 105 St.	1917	92,000.00	3	2,760.00	1,380.00*	88.00
17(a)	Furniture & Fixtures	various	9,600.00	15	1,440.00	1,440.00	112.00
6 mos.	TOTALS.....		\$		\$	\$	\$

SCHEDULE C

Explanation of deductions claimed in Items 18, 19 and 20 of Schedule A, and Item 22 (e) on page 2 of return

1. REFER TO ITEM NO.	2. EXPLANATION	3. AMOUNT	4. REFER TO ITEM NO.	5. EXPLANATION	6. AMOUNT
22(e)	Interest on mortgage	\$2125.00	20(a)	Insurance & Light	\$ 418.00
	Insurance, Light & Heat	1220.00		Paper & Twine	1240.00
	Supt. Janitor & El Man	2500.00		Advertising, Tel & Tel.	812.00
	Miscellaneous	118.00		Miscellaneous	760.00
* 6 mos.		5963.00			3230.00

SCHEDULE D

Explanation of basis used in apportioning income, if any, earned partly within and partly without the State of New York.

1. Refer to Item of return	2. Explanation
19 & 24A	George V. Brown received a salary of \$14,000 and interest on partners capital of \$5,000 from the partnership of Smith, Brown & Jones. As these are considered a distribution of profits, the amount of income is allocated to New York State on the same basis as the business in N.Y. State bears to the total business, i.e. 74.713%, see form 204-A.

SCHEDULE E

Statement of contributions to charitable, religious, scientific and educational corporations, incorporated by, or associations organized under the laws of the State of New York claimed as deduction in Item 26 (c) on page 2 of return.

1. NAME OF ORGANIZATION	2. AMOUNT	3. NAME OF ORGANIZATION	4. AMOUNT
N. Y. Bureau of Charities	\$1,000		\$
N.Y. Society Prevention of Cruelty to Children	100		
Distributive share of donations made by the partnership of Smith, Brown & Jones	900		
	2,000.00		

SCHEDULE F

If you carry on business (as defined in the regulations) both within and without the State of New York, give list of all places, both within and without the state, where you carry on business.

Line No.	1. STREET ADDRESS	2. CITY AND STATE	3. DESCRIPTION (Branch office, agency, factory, etc.)
1	412 East 125 Street	N.Y. City, N.Y.	Retail Shoe Store (main)
2	212 Market Street	Newark, N. J.	do (branch)
3			
4			
5			

SCHEDULE G

Allocation of factors used in apportionment of income, in accordance with method prescribed in Article 457 of the New York State Income Tax Regulations.

To be submitted only by nonresidents carrying on business (as defined in the regulations) both within and without the State of New York.

Line No.	1. DESCRIPTION OF ITEMS USED AS FACTORS	2. TOTALS (Within and without the State)	3. NEW YORK STATE AMOUNTS
1	(1) VALUE OF THE REAL AND TANGIBLE PERSONAL PROPERTY OF THE BUSINESS:	xxx xxx xxx xx	xxx xxx xxx xx
2	(a) At the beginning of the period covered by the return	\$ 16 760 00	\$ 9 390 00
3	(b) At the end of the period covered by the return	\$ 14 720 00	\$ 7 580 00
4	TOTAL OF LINES 2 AND 3	\$ 31 480 00	\$ 16 970 00
5	AVERAGE — [half of amounts on line 4]	\$ 15 740 00	\$ 8 485 00
6	(2) WAGES, SALARIES AND OTHER PERSONAL SERVICE COMPENSATION PAID DURING THE YEAR	\$ 14 400 00	\$ 8 400 00
7	(3) GROSS SALES OF MERCHANDISE, OR CHARGES FOR SERVICES, DURING THE YEAR	\$ 240 000 00	\$ 150 000 00
8	TOTALS	\$ 270 140 00	\$ 166 885 00
9	Enter the percentage which the total (line 8) of Column 3 is of the total of Column 2	61.777 . . %	{ Apply this percentage to Item 20 of Schedule A and enter in Item 21 on page 2 of return.

FIDUCIARY RETURN

In the following illustration of a fiduciary return filed for the calendar year 1920 the facts are as follows:

Decedent Vincent Brown
 Date of death of decedent..... July 3, 1919
 Name and address of fiduciary..... James E. Jerome,
 169 E. 69th St., N. Y. City
 Name and address of beneficiaries..... John J. Jones,
 100 First Pl., Flushing, L. I.
 George V. Brown,
 109 Main St., Newark, N. J.
 Share of each beneficiary in net income....50%.

DETAIL OF INCOME AND EXPENSES OF THE ESTATE FOR THE YEAR 1920

Income from shirt factories located at 70 Pearl St., New York City, and
 120 High St., Newark, N. J.

Total sales	\$588,400.00
Cost of goods sold.....	506,840.00
	\$ 81,560.00

Gross profit \$ 81,560.00

Other business deductions:

Salaries	\$29,500.00	
Interest on business indebtedness	5,915.00	
Taxes	2,875.00	
Depreciation and repairs.....	12,403.40	
Losses not compensated by in- surance	1,500.00	
Bad debts	797.00	
Light, heat and power	1,468.00	
Advertising	912.00	
Insurance	880.00	
Postage, telephone and telegraph	714.00	
Miscellaneous	519.00	
	57,483.40	\$24,076.60

Interest from bonds, bank deposits, notes, etc.....	2,688.40
Dividends on stock received in cash (from foreign corpora- tions not doing business in United States).....	2,880.00

<i>Carried forward</i>	\$29,645.00
------------------------------	-------------

<i>Brought forward</i>				\$29,645.00
Income from rents as follows:				
Apartment, 902 Clinton Ave., Brooklyn, N. Y.:				
Rents received				\$7,200.00
<i>Deduct:</i>				
Depreciation and re-				
pairs	\$	685.00		
Interest		1,166.67		
Taxes		750.00		
Light and heat		103.33		
Insurance		32.67		
Janitor and elevator				
man		660.00		
Settlement of suit ac-				
count of elevator ac-				
cident	2,000.00			
Miscellaneous	75.00	5,472.67	\$1,727.33	
Department store, 1110 Broadway, New York City:				
Rents received				\$42,000.00
<i>Deduct:</i>				
Depreciation	\$9,405.00			
Interest	18,000.00			
Taxes	10,000.00			
Insurance	1,500.00	38,905.00	3,095.00	
Apartment, 22 So. 4th St., Newark, N. J.:				
Rents received				\$ 5,760.00
<i>Deduct:</i>				
Depreciation and re-				
pairs	\$	598.00		
Interest		1,100.00		
Taxes		625.00		
Light and heat		110.00		
Insurance		32.50		
Janitor		500.00		
Miscellaneous		55.00	3,020.50	2,739.50
Garage, Main St., Newark, N. J.:				
Rent received				\$3,000.00
<i>Deduct:</i>				
Depreciation and re-				
pairs	\$	935.00		
Interest		2,090.00		
Taxes		1,050.00		
Insurance		70.00	4,145.00	1,145.00
				6,416.83
<i>Carried forward</i>				\$43,761.83

<i>Brought forward</i>			\$43,761.83
Loss on sale of securities:			
Sale price	\$16,920.00		
Appraised value July 3, 1919, date of death of testator	17,900.00		980.00
Income and loss on sale of two parcels of property as follows:			
Apartment, 902 Clinton Ave., Brooklyn, N. Y.:			
Sale price	\$96,200.00		
Value July 3, 1919, date of death of testator.....	\$90,000.00		
Less: Depreciation from the above date to date of sale	1,500.00	88,500.00	7,700.00
Apartment, 22 So. 4th St., Newark, N. J.:			
Sale price	\$46,000.00		
Value July 3, 1919, date of death of testator	\$52,000.00		..
Less: Depreciation from the above date to date of sale	1,040.00	50,960.00	4,960.00
			\$37,821.83
Deductions:			
Legal and accounting fees incident to the business management of the estate	\$ 312.00		
Expenses in connection with title search of apartment, Boston, Mass.	65.00		377.00
Net income of the estate			\$37,444.83

NEW YORK STATE INCOME TAX [1920]

DELIVER OR SEND
THIS RETURN TO
New York State
Income Tax Bureau
ALBANY, N. Y.

IF RETURN IS FOR
CALENDAR YEAR 1920
FILE IT
ON OR BEFORE
APRIL 15, 1921

If for a period other
than a calendar year
file it on or before the
15th day of the fourth
month following the
close of such period

FIDUCIARY RETURN

For the Calendar Year 1920 or Fiscal Period

Begun X X X X X X
and Ended X X X X X X 1920

PRINT NAMES AND ADDRESSES PLAINLY

1. Name of estate or trust { Estate of Vincent Brown
(State whether an estate or trust)
2. Name and address of fiduciary { James E. Jerome
169 East 69 Street
N. Y. City

NO TAX IS PAYABLE
WITH THIS RETURN

Each beneficiary should include his (or her) distributive share of the net income of the estate or trust in his (or her) individual return.

Receiving Stamp

Audited by

3. Was a return of income for 1919 filed on behalf of this estate or trust? Yes

DISTRIBUTION OF INCOME

4. Enter in the table below the name and residence address of each beneficiary, and show the share of each in the net income of the estate or trust (whether distributed or not) reported in Item 20 of this return. Enter the estate or trust as a beneficiary for retained income if any.

(a) NAME OF EACH BENEFICIARY	(b) RESIDENCE ADDRESS OF EACH BENEFICIARY	(c) SHARE OF EACH BENEFICIARY IN NET INCOME OF THE ESTATE OR TRUST (Amount to be reported by each beneficiary on individual return)
John J. Jones 50%	100 First Place, Flushing L.I.	\$ 18,722 41
George V. Brown 50%	109 Main Street, Newark, N.J.	* 18,722 42
(d) TOTAL.....		\$ 37,444 83

5. Did you (or will you) file a fiduciary return of income for this estate or trust for the period covered by this return, with a U. S. Collector of Internal Revenue? Yes

6. If so, what amount of Total Net Income did you (or will you) report? \$ 37,026 83

7. If the total net income reported on the U. S. return differs from the amount of Item 20 on this return, give principal items of difference, or, if you prefer, attach statement reconciling all differences.

Interest on Bonds of State of Penna. \$418.00 taxable under State but not under Federal.

8. Enter here all NON-TAXABLE INCOME received by (or accrued to) the estate or trust. (See Instruction 8 for non-taxable income)

Interest on N. Y. State Bds	180 00	\$	
Interest on Federal Farm Loan Bonds	800 00	\$	
		\$	
		\$	
		\$	
		\$	
		\$	

*Non-resident. See form 205-A attached for allocation to N.Y. State. [1920]

Form 205--Page 3 of Return

SCHEDULE A--Statement of contributions to (and amounts permanently set aside for) the United States, any state, territory or political subdivision thereof, or the District of Columbia or any corporation or association organized and operated exclusively for religious, charitable, scientific or educational purposes or for the prevention of cruelty to children or animals. (Item 18d--Page 2 of Return)

1.	2.	3.	4.
NAME OF ORGANIZATION	AMOUNT	NAME OF ORGANIZATION	AMOUNT
NONE			

SCHEDULE B--Statement of Deductions claimed for repairs, depreciation and depletion in Items 9 (r) and 13 (d)--Page 2 of return

1.	2.	3.	4.	5.	6.	7.	8.	9.
REFER TO ITEM 9 (r) OR 13 (d)	KIND OF PROPERTY (Principal material of which constructed)	LOCATION	DEATH OF TAXPAYER	COST OR VALUE ON JAN. 1, 1919, IF ACQUIRED PRIOR THEREOF (Exclude of land)	RATE	AMOUNT IN 1919	AMOUNT THIS YEAR	INCIDENTAL REPAIRS NOT INCLUDED IN DEPRECIATION DEDUCTIONS
9(r)	Factory (Brick)	20 Pearl St. N.Y. City	7/3/19	75,050 00	5	1,876 25	3,752 50	640 00
9(r)	Furniture & Fixtures	do do	do	4,600 00	15	345 00	690 00	80 00
9(r)	Machly & Equipt.	do do	do	18,200 00	10	910 00	1,820 00	714 00
9(r)	Factory (Brick)	120 High St. Newark, N.J.	do	63,140 00	3 1/2	1,104 95	2,209 90	420 00
9(r)	Furniture & Fixtures	do do	do	2,700 00	15	202 50	405 00	42 00
9(r)	Machly & Equipt.	do do	do	12,400 00	10	620 00	1,240 00	390 00
	Total			\$176,090 00		5,058 70	10,117 40	2,286 00
13(d)	Apartment (Stone)	902 Clinton Ave. Brooklyn	do	90,000 00	2	900 00	600 00	85 00
13(d)	Department Store (stone)	1110 Baw, N.Y. City	do	18,000 00	2 1/2	4,202 50	9,405 00	-
13(d)	Apartment (stone)	22 S 4th St. Newark, N.J.	do	52,000 00	2	520 00	520 00	78 00
13(d)	Garage (Concrete)	Main St. Newark, N.J.	do	45,000 00	2	450 00	900 00	35 00
	TOTAL			\$361,090 00		11,131 20	21,542 40	2,484 00

1.	2.	3.	4.	5.	6.
REFER TO ITEM NO.	EXPLANATION	AMOUNT	REFER TO ITEM NO.	EXPLANATION	AMOUNT
9-S	Embezzlement occurring during 1920	1500 00	9-U	Light, Heat & Power	1468 00
9-T	Horton Sewing Co. - Bankrupt \$165.			Advertising	912 00
	Green and Green - " 412.			Insurance	880 00
	Albert Shirt Co. Dishonored Note 220.	797 00		Postage, Tel & Tel	714 00
13(g)	Light, & Heat, etc.	103 33		Miscellaneous	519 00
	Insurance	32 67	13(g)	Total	\$4493 00
	Janitor & Elevator Man	660 00		Light and Heat	110 00
	Settlement of Suit a/o Elevator Accident	2000 00		Insurance	32 50
	Miscellaneous	75 00		Janitor	500 00
	Total	2871 00		Miscellaneous	55 00
13(g)	Insurance	1500 00	13(g)	Total	697 50
					70 00

AFFIDAVIT

I swear or affirm that to the best of my knowledge and belief the statements contained in this return, including the accompanying schedules and statement, (if any), are true and that this return is a true and complete statement, in accordance with the law and regulations, of all income, gains and profits received by or accrued to the estate or trust for which the return is made, and coming into the custody or control of the fiduciary during the taxable year 1920 and that all deductions entered or claimed herein are allowable under the law and regulations and that there is contained herein a true and complete statement of the names and addresses of all the beneficiaries entitled to share in this income and the amount of such beneficiary's share.

Sworn to and subscribed before me this _____ day of _____, 1921. (Signature of fiduciary or officer representing fiduciary)

(Signature of officer administering oath)

(Title)

(Address)

and not required

APPORTIONMENT OF INCOME OF ESTATE OR TRUST HAVING A NONRESIDENT BENEFICIARY AND CARRYING ON BUSINESS BOTH WITHIN AND WITHOUT THE STATE

1. Name of Estate or Trust..... Estate of Vincent Brown
2. Name of Fiduciary..... James E. Jerome
3. Address of Fiduciary..... 169 East 69th Street, New York City, N. Y.
4. This is part of the Fiduciary return for the year ended December 31, 1920.

THIS IS TO BE ATTACHED TO AND FILED WITH THE FIDUCIARY RETURN

INSTRUCTIONS

1. A nonresident beneficiary is taxable only on such part of his income from the estate or trust as arises from sources within the State of New York (exclusive of annuities, interest or dividends, except to the extent to which the same shall be a part of income from any business, trade, profession or occupation carried on in this state, subject to taxation).

2. If the estate or trust (a) has a nonresident beneficiary, and (b) carries on business, (as "business carried on" is defined in the regulations) both within and without the State of New York, the fiduciary shall accompany his return with a schedule of apportionment on Form 205-A.

Extracts from New York State Income Tax Regulations

Article 401. Tax on nonresidents. In the case of a nonresident, the tax is imposed upon his entire net income from sources within the State; that is (a) from all property owned and (b) from every business, trade, profession or occupation carried on in the State of New York. It is not imposed upon income arising from annuities, interest on bank deposits, interest on bonds, notes or other interest-bearing obligations or dividends from corporations, except to the extent to which the same shall be a part of the taxable income from any business, trade, profession or occupation carried on in this State. (Tax Law, sections 351 and 359.) (See article 415.)

Art. 418. Deduction. "Business carried on" within the State. A business, trade, profession or occupation (as distinguished from personal service as employee) is carried on within the State by a nonresident when he occupies, has, maintains or operates desk room, an office, a shop, a store, a warehouse, a factory, an agency or other place where his affairs are systematically and regularly carried on notwithstanding the occasional consummation of isolated transactions without the State. Business is being carried on if it is here with a fair measure of permanency and continuity. Its regularity or continuity need not be for a long period; the life of the business is not a material factor.

Art. 417. Sale of property other than securities. Gross income of a nonresident shall include all the profits derived from the sale, exchange or other disposition of real property located within the State of New York. It also includes all the profits derived from the sale, exchange or other disposition of personal property (other than stocks, bonds or other securities) having an actual situs within the State but not forming part of the assets of a business carried on within the State. Gross income from the sale, exchange or other disposition of real or personal property is determined in the same manner as gross income from similar sales by a resident. (See articles 24-29.)

Art. 416. Rents and royalties. The gross income of a nonresident from rents and royalties includes all rents and royalties received from property located within the State of New York and excludes all other rents and royalties. Such gross income is determined in the same manner as is the gross income of a resident from rents and royalties. (See articles 42 and 120.) Rent received by a nonresident for property located without the State is excluded from gross income regardless of the fact that payments may be made from a point within the State by a resident individual, partnership or corporation.

Art. 455. Business carried on wholly within the State. The entire net income of a nonresident from a business, trade, profession or occupation, carried on within the State (as "business carried on" is defined in article 415), and not carried on elsewhere, as so defined, is income from a source within the State of New York and taxable as such.

This is so, even though the nonresident or his representatives travel without the State for the purposes of the trade or business, that is for the purpose of buying, selling, financing or performing any duties in connection with the business, and even though he may be performing any other duty in connection with the business; and even though sales may be made to, or services performed for, or on behalf of, persons or corporations located without the State.

Art. 456. Business carried on wholly without the State. No part of the net income of a nonresident from a business, trade, profession, or occupation, carried on without the State of New York (as "business carried on" is defined in article 415), and not carried on as so defined within the State, is taxable.

This is so, even though the nonresident or his representatives may enter the State for the purpose of buying, selling, financing, or performing any other duty in connection with the business; and even though sales may be made to, or services performed for, or on behalf of, persons or corporations located within the State.

Art. 457. Apportionment of business income from business carried on both within and without the State. If a nonresident, or a partnership with a nonresident member, carries on business, (as "business

carried on" is defined in article 415) both within and without the State, the net business income therefrom must be apportioned so as to allocate to the State of New York a proportion of such income on a fair and equitable basis, in accordance with approved methods of accounting.

If the books of the taxpayer are so kept as regularly to disclose the proportion of his business income, which is earned from sources within the State, the return of the taxpayer shall disclose both the total income, and the part apportioned to the State of New York, and the basis upon which such apportionment is made. If such basis is approved by the Comptroller, the return will be accepted.

If the books of the taxpayer do not disclose the proportion of his net income from sources within the State of New York, his return, or if the basis of apportionment used by him shall not be approved by the comptroller, his amended return shall disclose his net income from business both within and without the State, and the tax will be calculated and collected upon the portion of his total net income from business which the aggregate of the New York State factors bears to the aggregate of the total factors as herein defined.

The "New York State factors" include the following:

(1) The average of the value of his real property and tangible personal property within the State, (a) at the beginning of the taxable year and (b) at the end of the taxable year, but only of property connected with the business.

(2) The total wages, salaries, and other personal service compensation paid during the taxable year to employees in connection with the business carried on (as defined in article 415) within the State.

(3) The gross sales, or charges for services performed, by or through an agency (of the kind enumerated in article 415) located within the State. The sales or charges to be allocated to New York shall include all sales negotiated or consummated by salesmen, or services performed by other representatives, attached to or sent from offices, or other agencies, situated within the State of New York.

The "Total Factors" include the following:

(1) The average of the value of all his real property and tangible personal property (a) at the beginning of the taxable year, and (b) at the end of the taxable year, both within and without the State, but only of property connected with the business.

(2) The total wages, salaries, and other personal service compensation paid by him during the taxable year, to employees connected with the business, whether within or without the State.

(3) The gross sales, or charges for services performed whether within or without the State.

"Business income" as used in this article excludes profits (or losses) from the sale, exchange or other disposition of real property and income from rents and royalties, income from these sources being taxable only if the property from which the income was derived is located within the State of New York, and in such case the entire net income from these sources is taxable. (See articles 417 and 418.)

Art. 470. Alternative basis of apportionment. The provisions of articles 451 to 470 dealing with the apportionment of income of non-residents earned from sources both within and without the State of New York are designed to allocate to the State of New York on a fair and equitable basis, a proportion of such income earned from sources both within and without the State. Any nonresident may submit an alternative basis of apportionment with respect to his own income and explain that basis in full in his return. If approved by the comptroller that method will be accepted instead and in place of the one herein prescribed.

If, pursuant to article 470 an alternative basis of apportionment is submitted, or a partnership with a nonresident member, other than that described in article 457, the schedule contained on this form must be filled out and submitted in addition to all information and data used in the alternative method of apportionment.

SCHEDULE A

Give list of all places, both within and without the state where the estate or trust carries on business, as defined in Article 415 of the New York State Income Tax Regulations.

Line No.	1. STREET ADDRESS	2. CITY AND STATE	3. DESCRIPTION (Branch office, agency, factory, etc.)
1	70 Pearl Street	N. Y. City	Factory (Main)
2	120 High Street	Newark, N. J.	do (Branch)
3			
4			
5			

SCHEDULE B

Allocation of factors used in apportionment of income, in accordance with method prescribed in Article 457 of the New York State Income Tax Regulations.

Line No.	1. DESCRIPTION OF ITEMS USED AS FACTORS	2. TOTALS (Within and without the State)	3. NEW YORK STATE AMOUNTS
1	(1) VALUE OF REAL AND TANGIBLE PERSONAL PROPERTY:	xxx xxx xxx xx	xxx xxx xxx xx
2	(a) At the beginning of the period covered by the return	\$ 258 431 30	\$ 152 984 75
3	(b) At the end of the period covered by the return	\$ 226 173 90	\$ 131 962 25
4	TOTAL OF LINES 2 AND 3	\$ 484 605 20	\$ 284 947 00
5	AVERAGE — (half of amounts on line 4)	\$ 242 302 60	\$ 142 473 50
6	(2) WAGES, SALARIES AND OTHER PERSONAL SERVICE COMPENSATION PAID DURING THE YEAR	\$ 348 200 00	\$ 228 806 00
7	(3) GROSS SALES OF MERCHANDISE, OR CHARGES FOR SERVICES, DURING THE YEAR	\$ 588 400 00	\$ 353 040 00
8	TOTALS	\$ 1 178 902 60	\$ 724 319 50
9	Enter the percentage which the total (line 8) of Column 3 is of the total of Column 2		76

SCHEDULE C

Apportionment of net income of estate or trust to State of New York.

Items of Income	TOTAL NET INCOME OF ESTATE OR TRUST		APPORTIONMENT TO STATE OF NEW YORK	
	1. DESCRIPTION OF ITEMS	2. AMOUNT (See note 1)	3. BASIS OF APPORTIONMENT	4. AMOUNT
10	Income from interest	\$ 2 688 40	See Note 2	\$ NONE
11	Income from dividends	\$ 2 880 00	See Note 2	\$ NONE
12	Income from partnerships, and from other estates and trusts	\$ NONE	The return of the partnership or the other estate or trust	\$ NONE
13	Income from business or profession	\$ 23 920 60	Proportion shown by Schedule B (lines 8 and 9)	\$ 14 696 81
14	Income from rents and royalties	\$ 6 260 83	Location of property (Article 418 of Regulations)	\$ 4 744 33
15	Profit from sale or exchange of stocks and bonds	\$ 980 00	See Note 2	\$ NONE
16	Profit from sale or exchange of lands, buildings and other property not dealt in as a business	\$ 2 675 00	Location of property (Article 417 of Regulations)	\$ 7 700 00
17	Other income	\$ NONE	See Regulations	\$ NONE
20	TOTAL	\$ 37 444 83	TOTAL OF NET INCOME ALLOCATED TO STATE OF NEW YORK	\$ 27 141 14

NOTE 1. Subtract general reductions (item 18) from sources of income to which they relate, or, if not related to any specific source, proportionately from all sources.

NOTE 2. If this source of income is part of the income from a business carried on in New York State, this is to be apportioned on the basis shown by Schedule B, lines 8 and 9. If not part of the income from any such business, no part is to be apportioned to the State of New York.

SCHEDULE D

Distributive shares of nonresident beneficiaries.

Enter in this schedule the name of each nonresident beneficiary, and his distributive share in the portion of the net income of the estate or trust allocated to the State of New York (Schedule C, column 4).

In the absence of any specific allocation of income under the will or deed of trust, every distribution shall be deemed to apply ratably to taxable and nontaxable income and to income from within as well as income from without the State of New York.

1. NAME OF NONRESIDENT BENEFICIARY	2. AMOUNT	3. NAME OF NONRESIDENT BENEFICIARY	4. AMOUNT
George V. Brown	\$ 13 570 57		\$

ESTATE OF VINCENT BROWN

DETAIL OF ITEMS CONTAINED IN SCHEDULE C, FORM 205A, PAGE 2

ITEM			
10	Income from interest	\$2,680.00	None
	Amount of tax paid on tax-free bonds	8.40	\$2,688.40
11	Dividends received in cash		
9	Income from shirt-manufacturing business	\$24,076.60	2,880.00
	Less: 1/2 of legal and accounting fees allocated to this income	156.00	61.440% (See Schedule B) \$14,696.81
13	Income from rents and royalties		
	Less: 1/2 of legal and accounting fees allocated to this income	\$6,416.83	
		156.00	6,260.83
	Income from rents:		
	Apartment, 902 Clinton Ave., Brooklyn, N. Y.	\$7,200.00	
	Department store, 1110 Broadway, New York City	4,200.00	\$49,200.00
	Expenses of apartment:		
	Repairs, depreciation, etc.	685.00	
	Interest	1,166.67	
	Taxes	750.00	
	Other expenses	2,871.00	
	Expenses of department store:		
	Repairs, depreciation, etc.	9,405.00	
	Interest	18,000.00	
	Taxes	10,000.00	
	Other expenses	1,500.00	
	1/2 of \$156 legal and accounting item allocated to N. Y. property	78.00	
14	Income from rent		44,455.67
15	Profit from sale of New York apartment		980.00
	Less: Sale of New Jersey apartment	\$7,700.00	
		4,960.00	
	Expense in re title search, item 18(f)	\$2,740.00	
		65.00	
	Profit from sale of New York apartment		2,675.00
	Total		\$37,444.83
			7,700.00
			\$27,141.14

PARTNERSHIP RETURN

In the following illustration of a partnership return filed for the calendar year 1920 the facts are as follows:

Name of partnership.....Smith, Brown & Jones.

Name of partnership.....Smith, Brown & Jones.
Address 871 Broadway, New York City.

Names and addresses of partners....Albert A. Smith,
42 West End Avenue, New York
City.

George V. Brown,
Newark, N. J.

John J. Jones,
100 First Pl., Flushing, L. I.

Distribution of profits.....Albert A. Smith, 30%

George V. Brown, 30%

John J. Jones, 40%

Non-taxable income:

Liberty bond interest	\$1,012.50
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Interest on New York State bonds.....	320.00
---------------------------------------	--------

\$2,232.50

Contributions :

Red Cross, New York City.....	\$2,000.00
-------------------------------	------------

Red Cross, New York City.....	\$2,000.00
Bellevue Hospital, New York City.....	1,000.00

\$3,000.00

DETAIL OF TAXABLE INCOME AND EXPENSES FOR THE YEAR 1920

Income from retail merchandising business carried on at 871 Broadway, New York City, and 42 Market Street, Newark, N. J.:

Total sales	\$3,540,000.00
-------------------	----------------

Total sales	\$3,343,000.00
Cost of goods sold	3,098,000.00

Gross profit on trading	\$ 442,000.00
-------------------------------	---------------

Other business deductions:

Salaries of partners:

Albert A. Smith	\$16,000.00
-----------------------	-------------

George V. Brown	14,000.00
-----------------------	-----------

John J. Jones	12,000.00
---------------------	-----------

\$42,000.00

Other salaries	68,000.00
----------------------	-----------

Rent of Boston store	6,000.00
----------------------------	----------

Interest on mortgage, etc.	16,000.00
---------------------------------	-----------

Taxes	2,820.00
--------------------	----------

Depreciation and repairs	9,971.00
--------------------------------	----------

Loss from hold-up of messenger.....	1,500.00
-------------------------------------	----------

<u>Bad debts</u>	980.00
------------------------	--------

Insurance	2,000.00
-----------------	----------

Advertising	6,000.00
-------------------	----------

Sationery and store supplies	8,200.00
------------------------------------	----------

Telephone and Telegraph	2,000.00
-------------------------------	----------

Light and heat	2,400.00
----------------------	----------

169,571.00

Carried forward.....	\$272,429.00
----------------------	--------------

<i>Brought forward</i>			\$272,429.00
Interest on bonds, bank deposits, notes, etc.....			4,228.00
Dividends on stock paid in cash (from foreign corporations not doing business in the United States).....			912.00
Income from rents, net of expenses, Garage, 402 Ave. A, New York City:			
Rents received		\$1,800.00	
Depreciation and repairs	\$228.00		
Interest on mortgage	200.00		
Light, heat, etc.	114.00		
Taxes	180.00	722.00	1,078.00
Loss on sale of securities:			
Sale price		\$9,600.00	
Value as of January 1, 1919, as to se- curities purchased prior to that date	\$8,400.00		
Cost as to those acquired after that date	1,900.00	10,300.00	700.00
Profit on sale of property:			
Sale price		\$18,600.00	
Value, January 1, 1919.....	\$16,000.00		
Less: Depreciation from that date to date of sale	480.00	15,520.00	3,080.00
Collection on account of bad debt written off in 1919.....			200.00
			<u>\$281,227.00</u>
<i>Deductions:</i>			
Tax on railroad tickets.....	\$ 18.00		
Auto license	100.00	\$118.00	
Interest on partners' capital account.....		15,000.00	15,118.00
Net income of the partnership.....			<u>\$ 266,109.00</u>

NEW YORK STATE INCOME TAX [1920]

DELIVER OR SEND
THIS RETURN TO
New York State
Income Tax Bureau
ALBANY, N. Y.

IF RETURN IS FOR
CALENDAR YEAR 1920

FILE IT
ON OR BEFORE
APRIL 15, 1921.

If for a period other
than a calendar year
file it on or before the
15th day of the fourth
month following the
close of such period.

PARTNERSHIP RETURN

For the Calendar Year 1920 or Fiscal Period

Began XXXXXXand Ended XXXXXX 1920

Do Not Write in These Spaces

PRINT NAME AND ADDRESS OF PARTNERSHIP PLAINLY

NAME Smith, Brown & JonesADDRESS 871 Broadway

(No.) (Street or Avenue or Rural Route)

New York City, N. Y.

(City, Village)

(Post Office)

(State)

NO TAX IS PAYABLE
WITH THIS RETURN

Each partner should
include his distribu-
tive share of the net
income of the partner-
ship in his individual
return

Receiving Stamp

Audited by

1. Did you file a partnership return for 1919? Yes2. If so, what address did you give on that return? Same as above3. Did you, during the calendar year 1920, pay to any individual, rent, wages, salaries or other fixed and determinable income of \$1000 or more? Yes

If so, secure from any district office Forms 105 and 106 and file a return of information

MEMBERS' SHARES OF INCOME

4. Enter in table below the name and residence address of each partner, and show the share of each in the net income of the partnership (whether or not distributed or withdrawn). Enter in Column 3, the distributive share of each partner in the net income reported in Item 19 on Page 2 of Return. Enter in Column 4 the salaries or other personal service compensation and interest, paid or credited to any partner, which is included in Cost of Sales, Expenses, or any other deduction.

Column 1	Column 2	Column 3	Column 4	Column 5
NAME AND ADDRESS OF EACH PARTNER AS SHOWN ON INDIVIDUAL RETURNS	INTEREST IN PARTNERSHIP (Percentage)	DISTRIBUTIVE SHARE OF NET INCOME REPORTED ON ITEM 19 OF RETURN	SALARIES, COMPENSATIONS, ETC., AND INTEREST PAID (OR CREDITED) TO PARTNERS INCLUDED IN COST OF SALES, EXPENSES OR OTHER DEDUCTIONS	TOTAL OF COLUMNS 3 AND 4 (To be reported on the individual return of each member)
Albert A. Smith, 42 West End Av. N.Y.	30%	\$79,832 70	\$21,000 00	\$100,832 70
Geo. V. Brown, 109 Main St. Newark	30%	\$79,832 70	\$19,000 00	\$98,832 70
John J. Jones, 100-1st Pl. Flushing	40%	\$106,443 60	\$17,000 00	\$123,443 60
	%			
	%			
TOTALS	100%	\$266,109 00	\$57,000 00	\$323,109 00

5. Did you (or will you) file a Partnership return for the period covered by this return with a U. S. Collector of Internal Revenue? Yes6. If so, what amount of INCOME TO BE ACCOUNTED FOR BY MEMBERS did you (or will you) report? \$265,741.00

7. If the total net income reported in the U. S. return differs from the amount of Item 19 on this return, give principal items of difference, or, if you prefer, attach a statement reconciling all differences.

Difference between Federal de- forward
preciation based on cost and from sale of Garage, based
State based on Jan. 1, 1919 \$916.00 on cost for Federal, and
1/1/19 for state 1042.00
Difference between loss on
sale of stock based on cost
for Federal and 1/1/19 val-
ue for State. 242.00

Net difference between 1284.00federal and state 368.00

8. Enter here all NON-TAXABLE INCOME received by (or secured to) the partnership.

Liberty Bond Interest	\$1,912 50		
Interest on N.Y. State Bds	\$320 00		

[1920]

13. PROFIT (OR LOSS) FROM SALE, EXCHANGE OR GIFT OF STOCKS AND BONDS (Not dealt in as a business and not included in Item 9) See Instruction 13

(a) SALE PRICE (ON FAIR MARKET VALUE OF PROPERTY RECEIVED IN EXCHANGE)..... \$ 9,600
 Less (b) As to securities acquired Prior to January 1, 1919, their fair market value on January 1, 1919..... \$ 8,400
 Less (c) As to securities acquired After January 1, 1919, their cost to you..... \$ 1,900
 \$ 10,300

700

14. PROFIT (OR LOSS) FROM SALE, EXCHANGE OR GIFT OF LANDS, BUILDINGS AND OTHER PROPERTY (Not dealt in as a business and not included in Items 9 or 13) See Instruction 14

If there was more than one sale or exchange during the year, submit separate statement in similar form for each sale and enter net profit (or loss) on Item 6 below.

(a) Kind of property..... GAREGE (b) Location..... 402 Ave. A. N.Y. City
 (c) Year acquired..... 1915 (d) Original cost..... \$18,200.00

(e) SALE PRICE (ON FAIR MARKET VALUE OF PROPERTY RECEIVED IN EXCHANGE)..... \$18,600
 (f) Fair market value on January 1, 1919, (or cost if acquired thereafter) of property sold or exchanged..... \$16,000
 (g) Cost of permanent improvements, if any, after January 1, 1919, or after date of purchase, if acquired since..... \$16,000
 (h) Total (Item f plus Item g)..... \$15,520

(i) Depreciation after January 1, 1919, or after date of purchase if acquired since..... \$480

(j) Net Profit on Sale, Exchange or Gift of Lands, Buildings, etc. (Item e minus Item i). (If net loss, enter in red ink and subhead)..... 3,080

15. OTHER INCOME (Describe each source separately and in full)

(a) Collection on account of Bad Debts written off in 1919..... 200

(b).....

(c).....

TOTAL INCOME FROM ABOVE SOURCES (Items 8 to 15 inclusive)..... 281,227

16. DEDUCTIONS (not claimed above)

(a) Interest.....

(b) Taxes upon real property (except assessments for local benefits) not deducted in Items 9 (c) or 12 (c).....

(c) Other taxes (except income taxes). State character and amount of each in Schedule 2, on R. Ticket \$18. Auto license \$100..... 118

OTHER DEDUCTIONS (Describe each separately and in full)

(d) Interest on partners' capital account..... 15,000

(e).....

TOTAL DEDUCTIONS..... 15,118

17. NET INCOME OF THE PARTNERSHIP (Item 16 minus Item 15)..... 266,109

Page 1 of Return

If the partnership (a) has a nonresident member, and (b) carries on business both within and without the State of New York, prepare schedule of apportionment on Form 204-A and attach it to this return.

SCHEDULE A—Statement of deductions claimed for repairs, depreciation and depletion in Items 9 (c), 9 (v), 12 (c)—Page 2 of Return

1. ITEMS TO WHICH 9 (c) OR 12 (c)	2. KIND OF PROPERTY (Principal material of which constructed)	3. LOCATION STREET OR AVENUE CITY	4. YEAR ACQUIRED	5. COST (OR VALUE ON JAN. 1, 1919, IF ACQUIRED BEFORE 1919) (Exclusion of land)	6. DEPRECIATION AND DEPLETION CLAIMED OFF SINCE JANUARY 1, 1919			9. EXCESSIVE DEPRECIATION NOT INCLUDED IN DEDUCTIONS
					6. RATE	7. AMOUNT IN 1919	8. AMOUNT THIS YEAR	
9(s) Building, (Brick)		871 Broadway, N.Y. City	1914	200,000	3%	3,000	3,000	872
9(a) Furniture & Fixtures		do do	Various	22,000	15%	3,300	3,300	87
9(v) Delivery Equipment		do do	1918	8,000	25%	2,000	2,000	712
				\$160,000		\$8,300	\$8,300	\$1,671
2(c) Garage (Concrete)		402 Ave. A, N.Y. City	1915	16,000	2%	320	160	68
				\$16,000		\$320	\$160	\$68
TOTALS								

SCHEDULE B—Explanation of deductions claimed in Items 9 (c), 9 (v), 12 (c) and 17 (c)—Page 2 of Return

1. REFER TO ITEM NO.	2. EXPLANATION	3. AMOUNT	4. REFER TO ITEM NO.	5. EXPLANATION	6. AMOUNT
9(t)	Loss from Hold-up of Messenger	\$1,500	9(v)	Insurance	2,000
9(u)	Debt of Green Co. Bankrupt	980		Advertising & Store Supplies	6,000
				Stationery	8,200
				Gas & Oil	2,000
				Light & Heat	2,400
2(f)	Light, Heat, etc.	114		Miscellaneous	1,700
TOTALS					22,300.00

Did you employ any person especially to prepare this return? _____ If so, give name and address.

AFFIDAVIT

STATE OF NEW YORK—COUNTY OF _____ ss:

I swear (or affirm) that to the best of my knowledge and belief the statements contained in this return and the accompanying schedules and statements (if any) are true, and that this return is a true and complete statement, in accordance with the law and regulations, of all income, gains and profits received by (or accrued to) the partnership during the taxable year 1920; and that all deductions entered or claimed herein are allowable under the law and regulations.

(Member of partnership)

Sworn to and subscribed before me this _____ day of _____, 1921.

(Signature of officer administering oath)

(Title)

Not required

APPORTIONMENT OF INCOME OF PARTNERSHIP HAVING A NONRESIDENT MEMBER AND CARRYING ON BUSINESS BOTH WITHIN AND WITHOUT THE STATE

1. Name of partnership. Smith, Brown & Jones
2. Address of partnership. 871 Broadway, New York City & 342 Market Street, Newark, N.J.
3. This is part of the partnership return for the year ended. December 31, 1920.

This is to be attached to and filed with the return of the partnership

INSTRUCTIONS

A nonresident member of a partnership is taxable on his distributive share of that portion of the partnership profits which is derived from sources within the State. That is, (a) from property owned, or (b) from a business, trade, profession or occupation carried on within the State. ☐

The profits of a partnership carrying on business both within and without the State, as defined in regulations, must be apportioned so as to show the net income of the partnership from sources within the State. Every distribution or credit of profits is deemed to apply ratably to all sources of income. The nonresident member must therefore include in his individual return his distributive share of the income of the partnership allocated to the State of New York in accordance with this schedule.

Extracts from New York State Income Tax Regulations

Article 401. (Revised). Tax on nonresidents. In the case of a nonresident, the tax is imposed upon his entire net income from sources within the State. This is the net income from all property owned, whether real or personal, and from all business, trade, profession or occupation carried on in the State of New York. It is not imposed upon income arising from annuities, interest on bank deposits, interest on bonds, notes or other interest-bearing obligations or dividends from corporations, except to the extent to which the same shall be included in the taxable income from any business, trade, profession or occupation carried on in this State. (Tax Law, sections 851a, 853b, and 858.) (See article 415.)

Art. 415. Definition. "Business carried on" within the State. A business, trade, profession or occupation (as distinguished from personal service as employee) is carried on within the State by a nonresident when he occupies, has, maintains or operates desk room, an office, a shop, a store, a warehouse, a factory, an agency or other place where his affairs are systematically and regularly carried on notwithstanding the occasional consummation of isolated transactions without the State. Business is being carried on if it is here with a fair measure of permanency and continuity, its regularity or continuity need not be for a long period; the life of the business is not a material factor.

Art. 417. Sale of property other than securities. Gross income of a nonresident shall include all the profits derived from the sale, exchange or other disposition of real property located within the State of New York. It also includes all the profits derived from the sale, exchange or other disposition of personal property (other than stocks, bonds or other securities) having an actual situs within the State but not forming part of the assets of a business carried on within the State. Gross income from the sale, exchange or other disposition of real or personal property is determined in the same manner as gross income from similar sales by a resident. (See articles 34-37.)

Art. 418. Rents and royalties. The gross income of a nonresident from rents and royalties includes all rents and royalties received from property located within the State of New York and excludes all other rents and royalties. Such gross income is determined in the same manner as is the gross income of a resident from rents and royalties. (See articles 42 and 170.) Rents received by a nonresident for property located without the State is excluded from gross income regardless of the fact that payments may be made from a point within the State by a resident individual, partnership or corporation.

Art. 445. Business carried on wholly within the State. The entire net income of a nonresident from a business, trade, profession, occupation, carried on within the State (as "business carried on" is defined in article 415) and not carried on elsewhere, as so defined, is income from a source within the State of New York and taxable as such.

This is so, even though the nonresident or his representatives travel without the State for the purposes of the trade or business, that is for the purpose of buying, selling, bartering, selling, bartering, or performing any duties in connection with the business, and even though sales may be made to, or services performed for, or on behalf of, persons or corporations located without the State.

Art. 455. Business carried on wholly without the State. No part of the net income of a nonresident from a business, trade, profession, or occupation, carried on without the State of New York (as "business carried on" is defined in article 415), and not carried on as so defined within the State, is taxable.

This is so, even though the nonresident or his representatives may enter the State for the purpose of buying, selling, bartering, or performing any other duty in connection with the business; and even though sales may be made to, or services performed for, or on behalf of, persons or corporations located within the State.

Art. 457. Apportionment of business income from business carried on both within and without the State. If a nonresident, or a partnership with a nonresident member, carries on business (as "business

carried on" is defined in article 415) both within and without the State, the net business income therefrom must be apportioned so as to allocate to the State of New York a proportion of such income on a fair and equitable basis, in accordance with approved methods of accounting.

If the books of the taxpayer are so kept as regularly to disclose the proportion of his business income, which is earned from sources within the State, the return of the taxpayer shall disclose both the total income and the part apportioned to the State of New York, and the basis upon which such apportionment is made. If such basis is approved by the Comptroller, the return will be accepted.

If the books of the taxpayer do not disclose the proportion of his net income from sources within the State of New York, his return, or if the basis of apportionment used by him shall not be approved by the comptroller, his amended return shall disclose all net income from business both within and without the State, and the tax will be calculated and collected upon the portion of his total net income from business which the aggregate of the *New York State Factors* bears to the aggregate of the total factors as herein defined.

The "New York State Factors" include the following:

(1) The average of the value of his real property and tangible personal property within the State, (a) at the beginning of the taxable year and (b) at the end of the taxable year, but only of property connected with the business.

(2) The total wages, salaries, and other personal service compensation paid during the taxable year to employees in connection with the business carried on (as defined in article 415) within the State.

(3) The gross sales, or charges for services performed, by or through an agency, (of the kind enumerated in article 415) located within the State. Two sales or charges to be allocated to New York shall include all sales negotiated or consummated by salesman, or services performed by other representatives attached to or sent from offices, or other agencies situated within the State of New York.

(4) The "Total Factors" include the following:

(1) The average of the value of all his real property and tangible personal property (a) at the beginning of the taxable year, and (b) at the end of the taxable year, both within and without the State, but only of property connected with the business.

(2) The total wages, salaries, and other personal service compensation paid by him during the taxable year, to employees connected with the business, whether within or without the State.

(3) "Business income" as used in this article, excludes profits (or losses) from the sale, exchange or other disposition of real property, stocks, bonds, and securities, and income from these sources being taxable only if the property from which the income was derived was located within the State of New York, and in such case the entire net income from these sources is taxable. (See articles 417 and 418.)

Art. 470. Alternative basis of apportionment. The provisions of articles 401 to 470 dealing with the apportionment of income of nonresidents earned from sources both within and without the State of New York are designed to be applied on a basis of apportionment on a fair and equitable basis. The proportion of such income earned from sources both within and without the State. Any nonresident may submit an alternative basis of apportionment with respect to his own income and explain that basis in full in his return. If approved by the comptroller, the method will be accepted instead and in place of the one herein prescribed.

If, pursuant to article 470 an alternative basis of apportionment is submitted, or a partnership submits any basis of apportionment other than that provided by articles 401 to 470, the taxpayer or partnership must file out and submit in addition to all information and data used in the alternative method of apportionment.

SCHEDULE A

Give list of all places, both within and without the state where the partnership carries on business as defined in Article 415 of the New York State Income Tax Regulations.

Line No.	1. STREET ADDRESS	2. CITY AND STATE	3. DESCRIPTION (Branch office, agency, factory, etc.)
1	871 Broadway	N.Y. City, N.Y.	Main Store
2	342 Market Street	Newark, N. J.	Branch Store
3			
4			
5			
6			
7			
8			
9			
10			

SCHEDULE B

Allocation of factors used in apportionment of income, in accordance with method prescribed in Article 457 of the New York State Income Tax Regulations.

Line No.	1. DESCRIPTION OF ITEMS USED AS FACTORS	2. TOTALS (Within and without the State)	3. NEW YORK STATE AMOUNTS
1	(1) VALUE OF PARTNERSHIP'S REAL AND TANGIBLE PERSONAL PROPERTY:	X X X X X X X X X X	X X X X X X X X X X
2	(a) At the beginning of the period covered by the return.....	\$ 921 700 00	\$ 713 500 00
3	(b) At the end of the period covered by the return.....	\$ 1 033 400 00	\$ 796 900 00
4	TOTAL OF LINES 2 AND 3:.....	\$ 1 955 100 00	\$ 1 510 400 00
5	AVERAGE — (half of amounts on line 4).....	\$ 977 550 00	\$ 755 200 00
6	(2) WAGES, SALARIES AND OTHER PERSONAL SERVICE COMPENSATION PAID DURING THE YEAR.....	\$ 110 000 00	\$ 81 000 00
7	(3) GROSS SALES OF MERCHANDISE, OR CHARGES FOR SERVICES, DURING THE YEAR.....	\$ 3 540 000 00	\$ 2 621 200 00
8	TOTALS.....	\$ 4 627 550 00	\$ 3 457 400 00
9	Enter the percentage which the total (line 8) of Column 3 is of the total of Column 2: 74.713 %		

SCHEDULE C

Apportionment of net income of the partnership to State of New York.

TOTAL NET INCOME OF PARTNERSHIP				APPORTIONMENT TO NEW YORK STATE	
Line No.	1. DESCRIPTION OF ITEMS	2. AMOUNT	3. BASIS OF APPORTIONMENT	4. AMOUNT	
1	Income from rents and royalties (Item 18-g of return).....	\$ 1 078 00	Location of property (Article 418 of Regulations).....	\$ 1 078 00	
2	Profit from sale or exchange of lands, buildings and other property not dealt in as a business (Item 14-k of return).....	\$ 3 080 00	Location of property (Article 417 of Regulations).....	\$ 3 080 00	
3	Business income (Balance of Item 19 of return).....	\$ 261 951 00	Proportion shown by Schedule B (lines 8 and 9).....	\$ 195 711 45	
4	Total (Item 19 of return).....	\$ 266 109 00	Total of net income allocated to State of New York.....	\$ 199 869 45	

SCHEDULE D

Distributive shares of nonresident members.

Enter in this schedule the name of each nonresident member, and his distributive share in the portion of the net income of the partnership allocated to the State of New York. (Schedule C, line 4—column 4.)

Each partner's distributive share is deemed to apply ratably to taxable and non-taxable income, and to income from sources within, as well as from sources without, the State.

NAME OF EACH NONRESIDENT PARTNER	AMOUNT	NAME OF EACH NONRESIDENT PARTNER	AMOUNT
George V. Brown	\$59,960 84		

THIS CERTIFICATE HAS NO EFFECT ON CITIZENSHIP OR VOTING RESIDENCE

CERTIFICATE OF TAXPAYER CLAIMING RESIDENCE IN THE STATE OF NEW YORK

(To be filed with withholding agent by resident of New York State, pursuant to section 366 of the tax law, for the purpose of claiming the benefit of such residence for income tax purposes.)

To (Withholding agent) (Date)

(Address)

I hereby declare that I am a resident of the State of New York; that I reside at

N. Y.

(Street and number)

(City, town or village)

(County)

Should I become a nonresident before July 1, 1921, I will promptly inform you of that fact and execute new certificate of residence on Form 102.

Are you married? If not, are you the head of a family?

(Signed)

THIS CERTIFICATE TO BE RETAINED BY EMPLOYER—NOT TO BE SENT TO THE COMPTROLLER

TO BE FILED WITH EMPLOYER, BY NONRESIDENTS,
PURSUANT TO SECTION 203 OF THE TAX LAW AS AMENDED,
FOR THE PURPOSES OF CLAIMING THE BENEFIT OF PER-
SONAL EXEMPTIONS

Form 102 (Revised 1920)
NEW YORK STATE
INCOME TAX

**CERTIFICATE OF NON-RESIDENCE
AND
CLAIM FOR PERSONAL EXEMPTION**

To _____ (DATE)
(EMPLOYER)

(ADDRESS)

I Heroby Certify that I reside at _____

and am entitled to personal exemptions aggregating \$ _____ as follows:

MARRIED AND LIVING WITH WIFE (OR HUSBAND) \$2000.....\$
Or SINGLE INDIVIDUAL (OR MARRIED AND NOT LIVING WITH WIFE OR HUSBAND) \$1000.....\$
Or HEAD OF FAMILY \$2000.....\$
And DEPENDENT PERSONS UNDER 18 YEARS OF AGE (OR INCAPABLE OF SELF SUPPORT BECAUSE
MENTALLY OR PHYSICALLY DEFECTIVE) \$200 EACH\$
TOTAL.....\$

THIS CERTIFICATE IS MADE FOR THE PURPOSE OF CLAIMING, AS A NONRESIDENT OF NEW YORK STATE,
THE BENEFIT OF PERSONAL EXEMPTIONS UNDER THE NEW YORK STATE INCOME TAX LAW.

(SIGNATURE) _____

(Face)

**NEW YORK STATE
INCOME TAX**

FORM
102
(REVISED, 1920)

**REPORT OF TAX
WITHHELD AT SOURCE**

PERSONAL SERVICE INCOME OF \$1000 OR MORE PAID TO A NONRESIDENT DURING THE CALENDAR YEAR 1920

SEE INSTRUCTIONS ON FORM 102A

DO NOT FOLD OR MAR THIS CARD

NAME IN FULL TO WHOM PAID

ADDRESS

NAME IN FULL BY WHOM PAID

ADDRESS

1. TOTAL PAID TO THIS EMPLOYEE DURING THE CALENDAR YEAR.....\$
2. PAID FOR SERVICES WITHIN THE STATE.....\$
3. AMOUNT OF PERSONAL EXEMPTION CLAIMED.....\$
4. BALANCE—AMOUNT ON WHICH TAX WAS WITHHELD.....\$
5. AMOUNT WITHHELD.....\$

1% FROM FIRST - - \$10,000 } OF THE AMOUNT
2% FROM NEXT - - \$40,000 } SHOWN AT ITEM
3% FROM ALL OVER \$50,000 } 4 ABOVE

*SEE ARTICLE 266, INCOME TAX REGULATIONS, FOR RULE OF APPORTIONING COMPENSATION FOR SERVICES PERFORMED PARTLY WITHIN AND PARTLY WITHOUT THE STATE.

(Reverse)

CERTIFICATE OF NON-RESIDENCE
AND
REPORT OF TAX WITHHELD AT SOURCE

INSTRUCTIONS FOR THE USE OF FORM 102 (REVISED, 1920)

1. For the purposes of the withholding at the source provisions of the law, the status of nonresident attaches to every person receiving personal service compensation, who has not filed with the employer a certificate (Form 101) of residence within the State of New York.
2. Unless a nonresident files with his employer a claim for personal exemption on Form 102 (revised 1920) the tax must be withheld on all payments of salaries, wages, commissions and other fixed and determinable annual or periodical compensation for personal services rendered by a nonresident in excess of \$1,000 or more during the calendar year.
3. If the nonresident makes a claim for personal exemption on Form 102 (revised 1920) the tax must be withheld only on payments exceeding the amount of personal exemption claimed by the nonresident.
4. If after filing Form 102, a nonresident's status changes during the year so that he is entitled to a greater amount of exemption than previously claimed, he may file an amended Form 102 (revised 1920) claiming such greater exemption, according to his new status, and the aggregate tax then to be withheld for the year is on payments exceeding the amount of the personal exemption thus claimed, only.
5. The employer is not obliged to verify the nonresident's claim for personal exemption. The certificate of the nonresident is all that the employer requires. The reverse side of Form 102 (revised 1920) is to be used as a report of tax withheld at the source.
6. No report or withholding is required if the amount paid for services within the State is less than \$1,000.
7. Do not report on this form any income other than compensation for personal services.
8. Where services are rendered by a nonresident partly within and partly without the State, withholding is based upon the amount paid for services within the State as determined by article 266 of the State Income Tax Regulations.
9. All reports on Form 102 (revised 1920) accompanied by return on Form 103 (revised 1920) must be filed with the New York State Income Tax Bureau on or before April 15 following the calendar year for which the report is made. The tax must be paid at the time of filing the return.

INSTRUCTIONS

1. For the purposes of the withholding at the source provisions of the law, the status of nonresident attaches to every person receiving personal service compensation, who has not filed with the employer a certificate (Form 101) of residence within the State of New York.

2. Unless a nonresident files with his employer a claim for personal exemption on Form 102 (revised 1920) the tax must be withheld on all payments of salaries, wages, commissions and other fixed and determinable annual or periodical compensation for personal services rendered by a nonresident in excess of \$1,000 or more during the calendar year.

3. If the nonresident makes a claim for personal exemption on Form 102 (revised 1920) the tax must be withheld only on payments exceeding the amount of personal exemption claimed by the nonresident at the following rates: 1% from the first \$10,000; 2% from the next \$40,000; 3% from all over \$50,000 of the amount in excess of such personal exemption.

4. If after filing Form 102, a nonresident's status changes during the year so that he is entitled to a greater amount of exemption than previously claimed, he may file an amended Form 102 (revised 1920) claiming such greater exemption, according to his new status, and the aggregate tax then to be withheld for the year is on payments exceeding the amount of personal exemption thus claimed, only.

5. The employer is not obliged to verify the nonresident's claim for personal exemption. The certificate of the nonresident is all that the employer requires. The reverse side of Form 102 (revised 1920) is to be used as a report of tax withheld at the source.

6. No report or withholding is required if the amount paid for services within the State is less than \$1,000.

7. Do not report on this form any income other than compensation for personal services.

8. Where services are rendered by a nonresident partly within and partly without the State, withholding is based upon the amount paid for services within the State as determined by article 266 of the State Income Tax Regulations.

9. All reports on Form 102 (revised 1920), accompanied by return on Form 103, must be filed with the New York State Income Tax Bureau on or before April 15, 1921.

10. The payments included in this return should not be reported in the return of information on Forms 106 and 108.

EXTRACTS FROM NEW YORK STATE INCOME TAX REGULATIONS

Article 261. (Revised). Deducting and withholding at source. Deducting and withholding is required as hereinafter stated with respect to all salaries, wages, commissions, gratuities, emoluments and other fixed and determinable annual or periodical compensation (see Art. 263) of whatever kind and in whatever form paid, credited or received, earned by any taxpayer for personal services, taxable under Article 18 of the Tax Law.

(a) Where the amount of such compensation for the calendar year is less than \$1,000, no deducting or withholding is required.

(b) Where the taxpayer files with the withholding agent a certificate of residence (Form 101) to the effect that he is a resident of the State, and setting forth his residence address within the State, no deducting or withholding is required.

(c) Where the taxpayer files with the withholding agent a certificate of nonresidence and claim for personal exemption on Form 102 (revised 1920) showing that he is a resident of the Commonwealth of Massachusetts, and setting forth his residence address therein, no deducting or withholding is required.

(d) In all other cases deducting and withholding is required of one per cent (1%) on the first \$10,000 or less, two per cent (2%) on the next \$40,000 or less, and three per cent (3%) of the excess over \$50,000, by which the amount of such compensation for the calendar year exceeds \$1,000 (if no certificate on Form 102 is filed) or the amount of the exemptions granted to such taxpayer under section 862 of the Tax Law, as shown by a certificate of nonresidence and claim for personal exemption (Form 102 revised) filed with the withholding agent by the taxpayer.

Art. 262. (Revised). Deducting and withholding in 1920. Withholding agents shall deduct and withhold as set forth in article 261 in respect of personal service compensation paid or credited to the payee at any time on or after January 1, 1920, except that if the employee left the service of the withholding agent prior to April 14, 1920 and was fully paid prior to that date, no duty or obligation in respect to such payments rests on the withholding agent, unless the status of employer and employee is again created during 1920, and further payments of compensation for personal services are made or credited in 1920. In other words, the provisions for deducting and withholding are effective from January 1, 1920 except as stated in this article.

Art. 263. Fixed or determinable annual or periodical income. Only income earned for personal services is subject to deducting and withholding. The statute specifies that every withholding agent shall deduct from all salaries, wages, commissions, gratuities, emoluments and perquisites. But other kinds of personal service income may be included if fixed or determinable, annual or periodical. Income is fixed when it is to be paid in amounts definitely predetermined. It is determinable whenever there is a basis of calculation by which the amount to be paid whenever there is a basis of calculation by which the amount to be paid annually or at an annual rate. It may be paid periodically. The word "periodical" is used in opposition to "annual" and means from time to time, whether or not at regular intervals. That the length of time during which the payments are to be made may be increased or diminished by the occurrence of some event or by the happening of an event, does not make the payments any the less determinable or periodical.

The following shall be deemed to be fixed and determinable annual or periodical compensation within the meaning of section 860 of the Tax Law:

Any payment made by way of salary, wage, commission, gratuity, emolument, perquisite or otherwise for personal services rendered if the amount thereof shall be

(a) determined in advance, to concurrent with or subsequent to the rendering of the service, and is

(b) based on personal services rendered by the hour, week, month, year or other period of time, or

(c) the performance of specified duties or of unspecified duties or of work done on or in connection with one or more of certain articles or parts thereof;

(d) work done on or in connection with one or more of certain articles or parts thereof;

(e) in cash,

(f) in board or lodging, or both,

(g) in the stock of any corporation,

(h) by promissory note or other obligation, or

(i) in property, service or otherwise.

If payment shall be made otherwise than in cash, it shall be considered and treated as payment in cash to the fair market value (determinable usually by understanding or agreement existing between the payor and the payee) of such medium, other than cash, as may be employed.

Fees for professional services are not subject to withholding unless contracted for or paid on an annual or periodical basis.

Art. 264. Year for purposes of deducting and withholding. Deducting and withholding of personal service compensation by withholding agents shall be on the basis of a calendar year, irrespective of the basis of reporting adopted by the payee-taxpayer. Personal service compensation shall be deemed to have been paid by the withholding agent and received by the payee-taxpayer only if or when the extent actually paid or credited to the payee and thus made reducible to possession by him. Commissions and all other forms of personal service compensation determined and paid or credited to a payee-taxpayer after the close of a calendar year, shall, for the purpose of deducting and withholding the tax and of returning information with respect thereto, be treated as if actually paid or credited in the calendar year when paid or credited, but for such purposes only. The approved method of accounting employed by the payee-taxpayer shall govern insofar as he may be killed upon to account for such payments for income tax purposes.

Art. 265. (Revised). Income not subject to deducting and withholding. Deducting and withholding from income is not required:

(a) In cases enumerated in subdivisions a, b and c of article 261.

(b) If the income is of a character other than compensation for personal services.

(c) Where the personal services are rendered entirely without the State, whether payment be made from within or without the State, irrespective of the status of the withholding agent. The occasional entry into the State of a non-resident employee who performs the duties for which he is employed entirely without the State, but enters the State for the purpose of reporting, receiving instructions, accounting, etc., incidental to his duties without the State, shall not be deemed to take such employee out of the class of those rendering their services entirely without the State.

(d) Where the personal services are rendered within the State if rendered for, and payment is made without the State by, a non-resident individual or partnership having no office or place of business or paying agent within the State, or a foreign corporation that (1) is not registered in New York and (2) has no office or place of business or paying agent within the State. (Nothing in sub-paragraph "d" shall be construed to relieve the recipient from liability to make return and pay the tax on such income.)

Art. 266. (Revised). Income of a nonresident for services performed partly within and partly without the State. In case a nonresident receives compensation for personal services rendered or performed partly within and partly without the State, the withholding agent shall deduct and withhold on that portion of the compensation which is earned within the State of New York in accordance with the following rules of apportionment:

(a) If the nonresident is a salesman, drummer, agent or other employee through whose services receipts or remuneration inure directly to the employer, the deducting and withholding shall attach to the portion of the entire salary which the volume of business transacted by the employee within the State of New York bears to the total volume of business transacted within and without the State by such employee.

(b) If the nature of the employment of the nonresident is such that receipts or remuneration for services rendered do not inure directly to the employer, as in the case of clerks, bookkeepers, or other laborers or other like classes of employees, the deducting and withholding shall attach to the portion of the personal service compensation income of such employee (a) which is earned within the State, bears to the time employed both within and without the State.

(c) If it is not possible to apportion the income as above provided, because of the peculiarities of the service of the employee, the apportionment shall be made in accordance with the facts and the taxes deducted and withheld accordingly. In such case a full statement of the facts shall be made to the Comptroller,

NEW YORK STATE INCOME TAX

FORM
105

RETURN OF INFORMATION AT SOURCE

REPORT OF INCOME OF \$1000 OR MORE PAID DURING THE CALENDAR YEAR 19_____

SEE INSTRUCTIONS ON FORM 105-A

DO NOT FOLD OR MAR THIS CARD

NAME IN FULL		TO WHOM PAID	KIND OF INCOME PAID	AMOUNT
ADDRESS			SALARIES, WAGES, FEES, COMMISSIONS, ETC.	\$
			RENT	\$
			INTEREST ON NOTES, MORTGAGES, ETC.	\$
NAME IN FULL		BY WHOM PAID	INTEREST ON REGISTERED BONDS	\$
ADDRESS			INTEREST ON BANK DEPOSITS	\$
			PREMIUMS AND ANNUITIES	\$
				\$

IS PAYEE MARRIED? _____ IF NOT, IS HE THE HEAD OF A FAMILY? _____

ON THE BLANK LINE ABOVE, ENTER THE KIND AND AMOUNT OF ANY OTHER INCOME EXCEPT AS NOTED ON INSTRUCTIONS

30487

NEW YORK STATE INCOME TAX

RETURN OF INFORMATION AT SOURCE

INSTRUCTIONS FOR USE ON RETURN OF INFORMATION—FORM 105

1. A separate return on Form 105 must be made for each individual taxpayer to whom any taxable income aggregating \$1,000 or more was paid during the calendar year.

2. These returns must be forwarded with summary and letter of transmittal on Form 106 to the New York State Income Tax Bureau, Albany, N. Y., on or before April 15 next following the calendar year for which the return is made.

3. Returns of information are not required of the following classes of payments:

- (a) Dividends.
- (b) Interest coupons payable to bearer.
- (c) Income exempt from taxation under §359, subdivision 2 of the tax law.
- (d) Bills paid for merchandise, telegrams, telephone, freight, storage, and similar charges.
- (e) To employees for board and lodging while traveling in the course of their employment.
- (f) Annuities, representing the return of capital.
- (g) Of rent, made to real estate agents (but the agent must report payments to the landlord if they equal or exceed \$1,000 annually.)
- (h) To nonresident employees, for services rendered ENTIRELY without the state.
- (i) To nonresidents, of annuities including pensions, interest on bank deposits, interest on bonds, or other interest-bearing obligations.
- (j) Fees for professional services except retainers on an annual or periodical basis.
- (k) To corporations, to partnerships and fiduciaries; and distributions by partnerships to partners and by fiduciaries to beneficiaries.

4. Payments to nonresidents from which tax was withheld, and which are reported on Forms 102 and 103, should not be included in this return of information.

5. Certificates of residence on Form 101 should be retained by the employer and not sent to the New York State Income Tax Bureau.

NEW YORK STATE INCOME TAX

ANNUAL SUMMARY AND LETTER OF TRANSMITTAL

RETURN OF INFORMATION AT THE SOURCE

FOR THE CALENDAR YEAR 1920

ON PAYMENTS OF

READ INSTRUCTIONS CAREFULLY

This summary and letter of transmittal accompanied by the returns on Form 105, must be filed with the New York State Income Tax Bureau, Albany, N. Y., on or before April 15, 1921.

INTEREST, RENT, SALARIES, WAGES, PREMIUMS, ANNUITIES, COMPENSATIONS, REMUNERATIONS, EMOLUMENTS, OR OTHER FIXED OR DETERMINABLE GAINS, PROFITS AND INCOME OF \$1,000 OR MORE DURING THE CALENDAR YEAR.

DO NOT WRITE IN
THIS SPACE

RECEIVING STAMP

No.

Name _____
(Person, Firm, Corporation, Organisation, etc., making payments)

Address _____
(No.) (Street or avenue or rural route)

(Post office and state)

Number of returns on Form 105.

Total amount of payments reported.

Examined by

\$

INSTRUCTIONS

1. Every individual, corporation or other organization, in whatever capacity acting, making payment to an individual of taxable income, except as shown below, of \$1,000 or more during the calendar year, must make a return of information thereon on Form 105 to the New York State Income Tax Bureau on or before April 15, 1921.

2. This form must be accompanied by returns on Form 105 showing in each case the name and business address of the person or organization by whom the payments were made, and the name and home address of the person to whom the payments were made, the kind of income and the amount.

3. Returns of information are not required of the following classes of payments:

- (a) Dividends
- (b) Interest coupons payable to bearer
- (c) Income exempt from taxation under section 359, subdivision 2 of the Tax Law
- (d) Bills paid for merchandise, telegrams, telephone, freight, storage and similar charges
- (e) To employees for board and lodging while traveling in the course of their employment
- (f) Annuities representing the return of capital
- (g) Of rent, made to real estate agents (but the agent must report payments to the landlord if they equal or exceed \$1,000 annually)
- (h) To nonresident employees, for services rendered entirely without the State
- (i) To nonresidents, of annuities, including pensions, interest on bank deposits, interest on bonds, or other interest-bearing obligations or dividends
- (j) Fees for professional services, except retainers on an annual or periodical basis
- (k) To corporations, to partnerships and fiduciaries, and distributions by partnerships to partners and by fiduciaries to beneficiaries

4. Payments to nonresidents which are reported on Forms 102 and 103 should not be included in this return of information.

5. Certificates of residence on Form 101 should be retained by the employer and not sent to the New York State Income Tax Bureau.

STATE OF _____, COUNTY OF _____, ss.:

I swear (or affirm) that the foregoing and the accompanying returns constitute a true and complete statement of all payments of income as described on this form, made by the person or organization named at the head of this form during the calendar year 1920, except payments of personal compensation to nonresidents and that such payments have been reported on Form 103,—Return of tax withheld at source.

Sworn to and subscribed before me this _____ day of _____, 1921

(Signature)

(Signature)

(Capacity in which acting)

(Title)

(State address of person signing if different from that given at head of return)

CLAIM FOR REFUND

INCOME TAXES
ERRONEOUSLY PAID OR ILLEGALLY COLLECTEDThis claim should be forwarded to New York State Income Tax Bureau,
Collection Division, Albany, N. Y.

RECEIVING STAMP

State of }
County of } ss:Print Name
of Claimant.....

(This should agree with name on return)

Address.....

The deponent, being duly sworn, deposes and says that this claim is made on behalf of the claimant named above, and that the facts stated below with reference to the claim are true and complete.

1. Amount of Tax paid \$..... 2. Amount of Refund now claimed \$.....
 3. Deponent verily believes that the amount stated in Item 2 should be refunded and now asks and demands refund of said amount for the following reasons:

4. Deponent further alleges that no claim has heretofore been presented for the refunding of the whole or any part of the amount stated in Item 2, and that no part has heretofore been refunded to claimant.

Sworn to and subscribed before me this

(Name)

day of, 192.....

(Name)

(Title)

AMOUNT ALLOWED \$.....

AUDITED BY

AUDITOR

APPROVED FOR PAYMENT

DIRECTOR

CHECK ISSUED

DATE

No.

NEW YORK STATE INCOME TAX

Return for the Calendar Year 1920 or
Fiscal Period

TAX RETURN FOR RESIDENT INDIVIDUALS [1920]

To be used by resident individuals whose ENTIRE income is derived from salaries or other personal service compensation, interest and dividends, or from partnership, estates and trusts.

Individuals who have other sources of income should use Long Form No. 201.

Nonresidents should use Form No. 203.

Began.....
and Ended.....1920

THIS RETURN MAY BE FILED AT ANY DISTRICT OFFICE OF THE NEW YORK STATE INCOME TAX BUREAU

IF THIS RETURN IS
FOR THE CALENDAR
YEAR 1920 FILE IT ON
OR BEFORE
APRIL 15, 1921.

If for a period other than a
calendar year file it on
or before the 15th day of
the fourth month follow-
ing the close of such
period.

Do not write in these spaces		Do not write in this space Amount Paid
PRINT NAME AND RESIDENCE ADDRESS PLAINLY BELOW		
NAME		
RESIDENCE ADDRESS	(First name in full—middle initials—last name in full)	
(No.)	(Street or avenue or rural route)	
	(City, Village, Post office and State)	
		Cashier's stamp No.

- Did you file a return for 1919? _____
- If so, what address did you give on that return? _____
- Did you, during 1920, pay to any individual, rent, salaries, wages, etc., or other fixed or determinable income of \$1000, or over? _____

(If so, secure Forms Nos. 105 and 106 from any district office and file a return of information.)

- Personal Exemptions—Report your status during the period covered by this return as defined in Instruction D7.
- Were you at any time during this period married and living with wife (or husband)? _____
- If not, were you the "head of a family" as defined in Instruction D7? _____
- How many dependent persons under 18 years of age (or mentally or physically defective) received their chief support from you during the year? _____
- What is the relationship to you of the dependent persons for whose support you claim exemption under Questions 5 and 6? _____
- Did (or will) your wife (or husband) or any of your dependent minor children make a separate return? (If so, give name and address thereof) _____
- If not, is the taxable income of your wife (or husband) and dependent minor children included in this return? _____
- Enter here all NON-TAXABLE INCOME received by (or accrued to) you or your wife (or husband) or any of your dependents, during the taxable year 1920. Exclude income of those filing separate returns. See Instruction E for non-taxable income.

\$		\$
\$		\$

- Did you (or will you) file an income tax return for the period covered by this return with a U. S. Collector of Internal Revenue? _____
- If so, what amount of Total Net Income did you (or will you) report? _____
- If the total net income reported on the U. S. return differs from the amount of Item 33 of this return, give principal items of difference, or, if you prefer, attach a statement reconciling all differences.

CALCULATION OF TAX

	Amount of Income Taxable at each Rate	Rate of Tax	Amount of Tax
14. Net income as shown by Item 33 (Page 2 of Return)	\$	17. 1% on first \$10,000 of Item 16..	\$
15. Less personal exemptions	\$	18. 2% on next \$40,000 of Item 16..	\$
		19. 3% on amount over \$50,000 of Item 16	\$
16. Balance SUBJECT TO TAX (Item 14 minus Item 15)	\$	20. TOTAL	\$

THE TAX MUST BE PAID IN FULL ON FILING RETURN
Make checks payable to COMPTROLLER OF THE STATE OF NEW YORK

AFFIDAVIT

STATE OF NEW YORK—COUNTY OF....., ss:

I swear (or affirm) that to the best of my knowledge and belief, the statements contained in this return including the accompanying schedules and statements (if any) are true, and that this return is a true and complete statement, in accordance with the law and regulations, of all income, gains and profits received by or accrued to me (or the person for whom this return is made) during the taxable year 1920, and that all deductions entered or claimed herein are allowable under the law and regulations.

Sworn to and subscribed before me this.....day of....., 1921.

(Signature of officer administering oath)
Seal not required

(Title)

(Signature of individual or agent)

(Address of agent)

[1920]

Form No. 200—Page 2 of Return
RETURN OF TAXABLE INCOME

(Include income of wife (or husband) and dependent minor children, unless reported in separate returns.)

21. INCOME FROM PERSONAL SERVICES (Salaries, Wages, Fees, Commissions, Bonuses, etc.)

(a) OCCUPATION OR TRADE	(b) NAME AND ADDRESS OF EMPLOYER	AMOUNT
		\$

*Show the gross amount received (or accrued); if deductions therefrom are claimed, report them under Item 21.
Do not include compensation paid by the United States.
See Instruction 21.*

22. INCOME FROM INTEREST

*Report interest received (or accrued) and collectible matured coupons.
Include interest on municipal or state bonds other than municipal or state bonds of the State of New York, as such interest is taxable.
Exclude exempt interest for which see Instruction 22.*

- (a) Interest (bonds or other corporate obligations; bank deposits, mortgages, notes, etc.).....\$
- (b) Amount of tax paid for taxpayer by debtor corporation on tax-free covenant bonds.....

23. INCOME FROM DIVIDENDS

*Report valuation of dividends received other than in cash.
See Instruction 23.*

- (a) Received in cash.....\$
- (b) Received in property (other than true stock dividends).....

24. INCOME FROM PARTNERSHIPS, ESTATES AND TRUSTS

Report your entire share, whether distributed or not, in the profits of the partnership (including salary and interest) or the income of the estate or trust, not merely the amount withdrawn by or paid to you.

- Give name and address of partnership, estate or trust. If estate or trust, give also name and address of fiduciary.*
- (a)\$
- (b)

25. Income from business or profession.....
26. Income from rents and royalties.....
27. Profit (or loss) from sale, exchange or gift of stocks or bonds.....
28. Profit (or loss) from sale, exchange or gift of lands, buildings or other property.....
29. OTHER INCOME (Describe each source separately and in full).....

(If you have income (or loss) from any of these sources, make return on Form 203 instead of on this form.)

X X X X X X X

Do not report exempt income here or income from sources described in Items 21-29.

- (a)\$
- (b)
- (c)

30. TOTAL INCOME FROM ABOVE SOURCES (Items 21 to 29 inclusive).....\$

31. DEDUCTIONS

- (a) Interest on indebtedness.....\$
- (b) Taxes upon real property (except assessments for local benefits).....
- (c) Other taxes (except income taxes). State character and amount of each.....
- (d) Contributions (submit details on Schedule A, below). (See Instruction 31d).....
- OTHER DEDUCTIONS (Describe each separately and in full).....
- (e)
- (f)

32. TOTAL DEDUCTIONS.....\$

33. NET INCOME (Item 30 minus Item 32) Enter on page 1, Item 14.....\$

SCHEDULE A Statement of Contributions to Charitable, Religious, Scientific and Educational Corporations and Associations claimed as deductions in Item 31 (d). This deduction must not exceed 15% of the amount of Item 33 plus Item 31d.

1 NAME OF ORGANIZATION	2 AMOUNT	3 NAME OF ORGANIZATION	4 AMOUNT
	\$		\$

SHORT FORM No. 200 — PAGE 1 OF INSTRUCTIONS **GENERAL INSTRUCTIONS**

WHEN TO USE FORM 201

1. Two forms of return are provided. This short Form 200 is designed for those whose *entire* income is derived from salaries, wages or other personal service compensation, interest and dividends, or from partnerships, estates or trusts. You should not use this short Form 200 if you have income from sources other than those mentioned, as for example, the following sources:
 - (a) Income from business or profession (except as a partner).
 - (b) Income from rents and royalties.
 - (c) Profit (or loss) from the sale or exchange of stocks or bonds.
 - (d) Profit (or loss) from the sale or exchange of lands, buildings or other property.
2. If for any reason you find that you cannot make a correct and complete return of all your income on Form 200 use Form 201, bearing in mind that you must make a complete statement of all your income from all sources.

A. HOW TO DECIDE WHETHER OR NOT TO MAKE A RETURN

1. Calculate your net income by filling in page 2 of the return according to instructions. Report all your taxable income from whatever source derived whether from within or without the State of New York.
2. Add the net income of your wife (or husband) and dependent minor children, if any, unless they file separate returns.
3. You should make the return if the total family net income, calculated in accordance with the law and these instructions, equals or exceeds:
 - (a) \$1,000 if you are single, or married and not living with your wife (or husband);
 - (b) \$2,000 if married and living with your wife (or husband).
4. See instruction D for personal exemptions.
5. When husband and wife should file separate returns:
 - (a) If not living together each should file separate returns as single persons, regardless of the fact that each may be the head of a separate family as defined under instruction D.
 - (b) If living together, and if each or both have separate incomes of \$10,000 or more.
 - (c) The additional exemption for being the head of a family or having dependents is not to be considered in deciding whether to make a return.
6. If husband and wife file separate returns the personal exemption of \$2,000 shall be divided equally between them.
7. If you were a nonresident during part of the year but were a resident of New York State at any time during the last six months of 1920, you are taxable as a resident on your income for 1920 from all sources whether earned within or without the state.

B. ACCRUED OR RECEIVED INCOME

1. You may make your return:
 - (a) On a cash basis; that is, reporting income received and expenses, etc., paid, or
 - (b) On an accrual basis; that is, showing income accrued and expenses, etc., incurred or accrued.
2. In accord with the method of accounting regularly employed in keeping your books, provided such method clearly reflects your true income.
3. If you do not keep books on the accrual basis you should report income received and expenses, etc., paid, but in any event, do not fail to include all your income even if it is not entered on your books.
4. If you report income on a cash basis you must include all income constructively received, such as bank interest credited to your account, or interest coupons due and collectible, but not collected, even though such income is not entered on your books.

C. PERIOD TO BE COVERED BY RETURN

1. The dates on which the period covered by the return began and ended, if other than the calendar year 1920, must be plainly stated at the head of the return.
2. You must report your net income for the calendar year 1920, unless you keep books of account which were regularly closed in 1920 at the end of some month other than December, in which case you should make your return for the fiscal year which ended during the calendar year 1920.
3. You may use this form for filing a return for a fiscal year ending in 1921, correcting the dates at the head of the return and in the affidavit.

D. PERSONAL EXEMPTIONS

1. If during the taxable year you were married and living with wife (or husband) or, if not married, were the head of a family, subtract from your net income, before calculating your tax, a family exemption of \$2,000, plus \$200 for each person under eighteen years of age (or incapable of self-support because mentally or physically defective) who received his or her chief support from you during the taxable year. If husband and wife make separate returns the exemption of \$2,000 shall be divided equally between them.
2. If you were not married, or did not live with wife (or husband), and if you were not the head of a family you are entitled to a personal exemption of \$1,000 plus \$200 for each person under eighteen years of age (or incapable of self-support because mentally or physically defective) who received his or her chief support from you during the taxable year.
3. A "head of a family" is a person who is the chief support of one or more persons living in his or her household, who are closely related to him, or her, by blood, marriage or adoption. An alien whose wife and family are abroad is not entitled to an exemption of \$200.
4. The personal or family exemption must be reported on Item 16 of the return and must be supported by answers to questions 4 to 7.

E. NON-TAXABLE INCOME

- The following classes of income are exempt from taxation and must not be reported on page 2 of the return but should be entered and reported in reply to question 10, on page 1 of the return:
1. Salaries, wages and other compensation received as an official or employee of the United States in either civil, military or naval service.
 2. Interest upon bonds or other obligations of the United States.
 3. Interest on securities issued under the provisions of the Federal Farm Loan Act of July 17, 1916, and on bonds of the War Finance Corporation.
 4. Interest on bonds or other obligations of the State of New York or of any municipal corporation or political subdivision of the State of New York (but interest on the obligations of other states and their political subdivisions is taxable).
 5. Interest on bonds or other obligations on which the investment tax was paid to the State of New York between June 1, 1917, and May 14, 1919, only during the period of years for which such tax shall have been paid.
 6. Gifts and money and property acquired under a will or by inheritance (but the income derived therefrom must be included in gross income, subject to the provisions of the law). Bonus or other compensation received in consideration for services rendered are, however, taxable.
 7. Proceeds of life insurance policies and contracts paid on the death of the insured, to individual beneficiaries or the estate of the insured (but the income therefrom must be reported).
 8. The amount received from accident and health insurance and under Workmen's Compensation Acts and the amount of any damages received by suit or agreement on account of personal injuries or sickness.
 9. Pensions are not taxable if received because of personal injuries or sickness. If pensions (other than those from the United States) are received for any other reason the amounts received must be reported when they exceed the aggregate of contributions made by the taxpayer toward the pension.

F. RECONCILIATION WITH U. S. RETURN

- If there is any considerable difference between the total net income you did (or will) report on your U. S. return and Item 33 of this return you should prepare a statement reconciling all differences which, if not filed with the return, should be retained, as you may be required to submit such a statement later.

G. WHEN AND WHERE THE RETURN SHOULD BE FILED AND TAX PAID

1. District offices of the Income Tax Bureau have been established at the following places:

<i>In the City of New York:</i> Borough of Manhattan Borough of The Bronx Borough of Brooklyn Jamaica	Binghamton Buffalo Elmira Kingston	Albany Rochester Syracuse Utica White Plains
---	---	--
2. You may send or bring your return to any one of the district offices of the Income Tax Bureau; but it is desirable that you send it to the office nearest your residence or place of business.
3. The total tax due must be paid in full at the time this return is filed and at the office at which the return is filed. Unless paid when due penalties will be imposed.
4. If this return is for the calendar year 1920, it should be filed and the tax paid on or before April 15, 1921. If the return is for a period other than a calendar year it should be filed on or before the 15th day of the fourth month following the close of such period.
5. *You will save time and find it more convenient if you will mail your return to the appropriate district office accompanied by a check, bank draft or money order drawn to the order of the "Comptroller of the State of New York," addressing it to the "New York State Income Tax Bureau" in the city in which you decide to file your return. Checks do not have to be certified.*
6. Do not send cash through the mail or pay it in person except at an office of the State Income Tax Bureau.
7. If you pay in cash do not fail to secure a cash-register receipt at the time of payment. If you pay by check or money order that will serve as your receipt; but you can secure an additional receipt, on request.

H. PENALTIES

- The law imposes severe penalties for failing to make a return, for making a false or fraudulent return and for failing to pay the tax when due.

DETACH THIS INSTRUCTION SHEET BEFORE FILING YOUR RETURN

FORM No. 200 — PAGE 2 OF INSTRUCTIONS

IMPORTANT

First read the instructions carefully before you proceed. If you can fill out the return yourself do so. If not, go to any district office and the form will be filled out without charge. File your return as early as possible, as assistance cannot be given to those who wait until the last days of the collection period before filing their returns.

NOTE: The following instructions for filing in page 2 of the return are numbered to correspond with the questions of the return and relate to the corresponding questions and items therein.

SPECIFIC INSTRUCTIONS

INSTRUCTION 21—INCOME FROM PERSONAL SERVICES, SALARIES, WAGES, FEES, COMMISSIONS, BONUSES, ETC.

Report personal service compensation received by you or your wife (or husband) or dependent minor child from any one employer, of \$1,000 or more during the year, on a separate line together with the occupation or position and the employer's name and address. All other income from personal services of less than \$1,000 from any one source should be combined and reported on a single line.

INSTRUCTION 22—INCOME FROM INTEREST

(a) Report here all interest received (or accrued) during the year except interest on bonds or other obligations, the income of which is exempt as stated in Instruction E on page 1 of instructions.

(b) Report in Item 22(b) the amount of tax paid for, or reimbursed to, taxpayer by debtor corporations on bonds containing tax-free covenant.

(c) If you have purchased bonds or other interest-bearing obligations and paid accrued interest in addition to the purchase price, exclude the amount of accrued interest that you paid at the time of purchase from the first interest payment received by you.

INSTRUCTION 23—INCOME FROM DIVIDENDS

(a) Report here all income from dividends including those from personal service corporations whether received in cash, or other property including scrip dividends, but not including true stock dividends.

(b) When dividends are received in property, the fair market value of property (or scrip) at the time made payable, should be reported, and a statement should be attached to the return explaining the valuation placed on such dividends.

(c) The time when the profits distributed in dividends were earned by the corporation is of no significance under the State Income Tax Law.

INSTRUCTION 24—INCOME FROM PARTNERSHIPS, ESTATES AND TRUSTS

(a) If you receive a salary from a partnership in addition to the amount reported in this item, report such salary in Item 21. The amount reported by you should agree with the amount reported in Item 4, column 5 of the partnership return.

(b) Report your share (whether received or not), in the profits of the partnership or in the income of the estate or trust. If the accounting period of the partnership or the fiduciary differs from the period covered by this return report your share for the accounting period of the partnership or fiduciary which ended during your taxable year.

(c) The New York State Income Tax Law differs from the Federal law in that personal service corporations are not classed as partnerships. Do not report the distributive share of the income of any personal service corporation of which you may be a member but report in Item 21 the salary, and in Item 23, the dividends received by you, if any.

INSTRUCTION 25—INCOME FROM BUSINESS OR PROFESSION (INCLUDING FARMING)

If you have any income (or loss) from business or profession carried on by you, use Form 201 and not this form.

INSTRUCTION 26—INCOME FROM RENTS AND ROYALTIES

If you have any income (or loss) from rents and royalties, use Form 201 and not this form.

INSTRUCTION 27—PROFIT (OR LOSS) FROM THE SALE, EXCHANGE OR GIFT OF STOCKS AND BONDS

If you have any profit (or loss) from this source or if, during the year you sold or exchanged any stocks or bonds, use Form 201 and not this form.

INSTRUCTION 28—PROFIT (OR LOSS) FROM THE SALE, EXCHANGE OR GIFT OF LANDS, BUILDINGS AND OTHER PROPERTY

If you have any profit (or loss) from this source, or if, during the year you sold or exchanged any lands, buildings, or other property, use Form 201 and not this form.

INSTRUCTION 29—OTHER INCOME

Amounts received in payment of accounts previously written off as worthless should be included here.

INSTRUCTION 31—GENERAL DEDUCTIONS

(a) *Interest on Indebtedness:* Report here interest paid or accrued on indebtedness. All interest paid or accrued is deductible.

(b) *Taxes on real property:* Report here all taxes upon real property except taxes or assessments for local improvements of a kind tending to increase the value of the property assessed.

(c) *Other taxes:* Report here personal taxes and all taxes not deducted above except income taxes or estate or inheritance taxes.

(d) *Contributions.* Report here only contributions made during the period covered by your return to corporations or associations operated exclusively for religious, charitable, scientific or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private stockholder or individual, or to the special fund for vocational rehabilitation authorized by the vocational rehabilitation act. The deduction for contributions must not exceed 15 per cent of your net income computed without the benefit of this deduction.

(e) *Bad Debts:* Bad debts ascertained to be worthless and charged off during the year, should be reported here. In the case of debts created prior to January 1, 1919, only their value on that date can be deducted upon subsequently ascertaining them to be worthless.

FRANCHISE TAX ON BUSINESS CORPORATIONS

5-19-20-300,000 (7-17706)

Every corporation incorporated prior to July 1, 1920, must make this report.

To STATE TAX DEPARTMENT, ALBANY, N. Y.

This report is DUE JULY 1, 1920, if the corporation made a report of net earnings to the United States Treasury Department before June 1, 1920, or if the corporation completed no fiscal year prior to July 1, 1920.
The report must cover the conditions and the entire net income for the corporation's last fiscal year ending on or before June 30, 1920.
Corporations filing reports with the United States Treasury Department after June 1, 1920, for a fiscal year ending before July 1, 1920, must file this report within thirty days after such filing.

Name of corporation _____
(Exact corporate title)

Mail address _____

I make the following report of such company for the year ending DECEMBER 31, 1919, or the fiscal year ending

_____ pursuant to Article 9-A of the Tax Law.
(Date inserted above must be the same as given in answer to (3) below)

- (1) Organized _____, 19____, under the Laws of _____
(2) Began business in New York _____, 19____
(3) If not incorporated under the laws of New York, has it been legally authorized to do business in New York State? _____
(4) Authorized capital stock, \$ _____ (5) Issued capital stock, June 30, 1920, \$ _____
(If organized with shares without par value, insert the number of shares issued)
(6) Amount of average indebtedness for year, \$ _____
(7) Has your fiscal year been changed since July 1, 1917? _____
(8) ENTIRE NET INCOME FOR THE YEAR ENDING DECEMBER 31, 1919, or the FISCAL YEAR (PERIOD) COMMENCING

AND ENDING

_____ shown by its report to the UNITED STATES TREASURY DEPARTMENT without deduction for excess profit, normal income tax or the \$2,000 allowed by the Federal Government as an exemption, \$ _____
(Note: The above answer must be based on the last report filed with the Federal Government for a period ending between July 1, 1919, and June 30, 1920, inclusive.)

- (9) Dividends received from domestic corporations not personal service corporations, and dividends upon stock of foreign corporations taxable by the United States upon any portion of their net incomes, \$ _____
(10) State amount of interest received from Federal obligations and not included in item (8), \$ _____
(11) State the amount, if any, allowed by the Federal Government for losses sustained in prior years, \$ _____
(12) If the entire net income as first returned was changed by the Federal Government, state the amount of such entire net income as finally determined for the year ending _____, 1917, \$ _____; _____, 1918, \$ _____
(If no change made insert the word "None")
(13) If a corporation is not organized under the laws of any state within the United States it should return its entire net income, wherever earned, \$ _____
(14) If the amount reported is inaccurate, state the amount claimed to be correct, \$ _____
(15) Nature of business and how transacted _____
(16) Place, street and number where business is conducted _____
(17) State the city or town, street number and state where the company maintained any permanent store, warehouse, factory or other place of continuous business outside the State of New York during the year _____

- (18) Any corporation taxable hereunder may omit from this report the segregation of assets on page 2 only by signing the following consent:
I AM AUTHORIZED by the Board of Directors of this corporation to consent and I do hereby consent that said corporation be taxed upon its entire net income at 4 1/2 per cent or upon its entire issued capital stock at one mill on the dollar, as provided by law.

Do not sign consent unless taxable by the State of New York on entire income or entire issued capital stock.

(Official title)

- (19) Does this corporation own a majority of the stock of another or other corporations? _____
If so, give name of each and amount held _____
(20) Is a majority of the stock of this corporation owned by another corporation? _____ If so, by what other? _____
(21) Did this corporation file a consolidated report with the United States Treasury Department? _____
(22) Were its income and assets included in the consolidated report of another corporation? _____
If so, name of corporation reporting the consolidated net income _____
(23) Give the names and net income or loss attributable to each corporation included in the consolidated report, and specify whether gain or loss _____
_____ \$ _____ \$ _____
_____ \$ _____ \$ _____
(24) Has this corporation since January 1, 1917, either directly or indirectly, acquired by merger, consolidation or purchase, the major part of the assets or the franchise of any other corporation or corporations? _____
If so, give name of each corporation and date of acquisition _____

THIS REPORT MUST BE VERIFIED ON PAGE FOUR

ALL QUESTIONS ON THIS PAGE MUST BE ANSWERED

SEGREGATION OF ASSETS

Note: This segregation must be made unless the consent under Paragraph 18, Page 1, has been signed.

TOTAL SEGREGATED ASSETS WHEREVER LOCATED

(a) Average total monthly value for the fiscal or calendar year of bills and accounts receivable arising from personal property sold by the corporation from merchandise manufactured by it within and without this state.	\$			
(b) Average total monthly value for the fiscal or calendar year of bills and accounts receivable arising from the purchase, or sale of, or trading in, personal property, or from services performed by the corporation, its officers or agents, excluding those arising in any way from advances or loans.	\$			
1/2 Average monthly value of all its real property wherever located (actual value).	\$			
1/2 Average monthly value of all its tangible personal property wherever located (actual value).	\$			
Total	\$			
1/2 Average total actual value of shares of stocks of other corporations owned by this corporation.	\$			
ASSETS SEGREGATED TO NEW YORK STATE ONLY				
(a) Average monthly value of bills and accounts receivable arising from personal property sold by the corporation from merchandise manufactured by it within this state.	\$			
(b) Average monthly value of bills and accounts receivable arising from personal property owned by the corporation and not manufactured by it within this state but sold by it or its agents and located within the state at the time of the receipt of the order.	\$			
(c) Average monthly value of bills and accounts receivable arising from the purchase or sale of, or trading in, goods, wares or merchandise not located at any place at which the corporation conducted a permanent or continuous business without the state and where the bills and accounts receivable arose from orders received or accepted by any officer or agent, or at any place of business, in this state.	\$			
(d) Average monthly value of bills and accounts receivable arising from services performed by any officer, agent or representative of the corporation connected with, sent from, or reporting, either directly or indirectly, to any officer located in this state or at any office located, owned, rented or occupied in this state.	\$			
1/2 Average monthly value of its real property within this State as detailed in this report (actual value).	\$			
1/2 Average monthly value of its tangible personal property in New York State as detailed in this report (actual value).	\$			
Total	\$			
1/2 Average total actual value of shares of stocks of other corporations owned by it and allocated to this State by rule below.	\$			

NOT TO BE FILLED

NOT TO BE FILLED

1/2 Real property and tangible personal property shall be taken at its actual value where located.
 1/2 The value of shares of stock of another corporation owned by a corporation liable hereunder shall for purposes of allocation of assets be apportioned in and out of the State in accordance with the value of the physical property in and out of the State representing such share stock.
 Note: If the amount of the annual net income of any corporation, tangible under this article as returned to the United States treasury department is changed or corrected by a Commissioner of Internal Revenue or other officer of the United States, such corporation, within ten days after receipt of such notification of change or correction, shall make return under oath or affirmation to the Tax Commission of such changed or corrected net income upon which the tax is required to be paid to the United States.

DISTRIBUTION SCHEDULE

(Must be completed)

If the company's entire real and tangible personal property in this State is in one city, or in one town outside a city or incorporated village, the schedules below need not be made, but the name of the city or town, and of the county where located must be entered in panel.

City or town.
Incorporated village.
County.

If the company has real or tangible personal property in an incorporated village (or villages) in this State the name of such village and the town and county where such village is located must be entered below, together with the value of such property.

Incorporated village of	In the town of	County of	Personal	Real
			\$	\$

(If more space is needed add a poster)

The values of real and tangible personal property in villages must be distributed to the proper TOWNS in the table below. Do not confuse the political subdivisions "incorporated village" and "town." Names of hamlets or postoffices other than incorporated villages are not wanted.

Schedule of Real and Tangible Personal Property in New York State by Cities and Towns		Personal, actual value	Real estate, actual value	Real estate, assessed value
City of	County of	\$	\$	\$
City of	County of	\$	\$	\$
City of	County of	\$	\$	\$
City of	County of	\$	\$	\$
Town of	County of	\$	\$	\$
Town of	County of	\$	\$	\$
Town of	County of	\$	\$	\$
Town of	County of	\$	\$	\$
Town of	County of	\$	\$	\$
Town of	County of	\$	\$	\$

(If more space is needed add a poster)

NOTE CAREFULLY:

- The segregation below need not be made by
1. Any corporation whose entire assets or business are in New York State.
 2. Any corporation consenting under paragraph (18) of this blank.
 3. Any corporation whose tax upon its entire net earnings would be greater than upon its issued capital stock at one mill, as apportioned under Article 9-A of the Tax Law.

SEGREGATION FOR ONE MILL TAX ONLY

ASSETS IN NEW YORK STATE		ASSETS OUTSIDE NEW YORK STATE	
(a) Average monthly bank and cash balance		(a) Average monthly bank and cash balance	
employed during the year.....	\$.....	employed during the year.....	\$.....
(b) Average value of bills and accounts receivable during the year.....	\$.....	(b) Average value of bills and accounts receivable during the year.....	\$.....
(c) Average value of bonds, loans on call and other financial securities held, used or employed in New York during the year.....	\$.....	(c) Average value of bonds, loans on call and other financial securities held, used or employed outside the State of New York during the year.....	\$.....
Total of above.....	\$.....	Total of above.....	\$.....
R. E.	\$.....	R. E.	\$.....
P. P.	\$.....	P. P.	\$.....
	\$.....		\$.....
		Grand total, \$.....	

Don't Fill

PENALTIES

Any OFFICER making a fraudulent report becomes personally liable to a FINE OF \$1,000.

The Law provides a PENALTY of not more than \$5,000 for neglect or refusal to file this report.

FOR FAILING, THROUGH NEGLIGENCE, TO PAY TAX WHEN DUE:

Ten per cent of the tax due and unpaid plus interest at the rate of 1 per cent per month during the period in which it remains unpaid.

INFORMATION

The word "average" wherever it appears in this report has its plain, ordinary significance; neither the highest amount nor the lowest, but the mean.

In making report every space must be used except where the blank states that the spaces are not to be filled. Wherever no figures are to be inserted the word "none" should be inserted.

If there is no net income to be returned in answer to paragraph (8) do not use figures but insert the word "deficit" or "none."

New corporations which have NOT issued any capital stock PRIOR to July 1, 1920, MUST answer paragraph (5) by the word "NONE."

ALL CORPORATIONS MUST MAKE THIS REPORT EXCEPT THE FOLLOWING:

(1) Real estate corporations wholly engaged in the purchase and sale of and holding title to real estate for themselves (this does not include so-called real estate companies having leasehold interests only, or real estate agents or brokers).

(2) Corporations whose sole business consists of holding stocks of other corporations for the purpose of controlling the management and affairs of such other corporations, except such as are specifically subject to report under the provisions of subdivision nine of section two hundred and eleven of the tax law.

(3) Transportation, transmission, heating, lighting and power corporations, insurance companies, banks, savings banks, trust companies and other corporations taxable under Sections 184 to 189 of the tax law inclusive.

WHEN AFFIDAVIT SHOULD BE FURNISHED:

Any corporation which has never issued any stock or has disposed of all its assets and abandoned its charter must file an affidavit equivalent in substance to form 30 of this department which will be supplied upon request. Simply to write "out of business," "never began business," "dead," et cetera, is not a sufficient compliance to relieve from the penal provisions of the statute.

Checks to pay taxes should not be sent to this department in any case. All taxes are payable to the State Comptroller but check should not be sent to him until a bill is received.

STATE OF NEW YORK, } ss.
County of _____ }

(Official title)

Notary Public

President _____

Secretary _____

Treasurer _____

FILE WITH
STATE TAX DEPARTMENT
ALBANY, N. Y.

REPORT DUE JULY 1, 1920

Dated at....., N. Y.

.....192.....

To the State Tax Commission

Albany, N. Y.:

I hereby swear that the delinquency in filing franchise return on Form 3 I.T. for the tax year beginning November 1, 1920, which return was due July 1, 1920, for.....

(Give name and address of delinquent corporation)

as required by the Act of June 4, 1917, Chapter 726 and acts amendatory thereof, was not due to any intent to violate the law or evade taxation, but was due to.....

(Here insert clearly and concisely the cause of the delay)

Desiring to compromise the liability, I hereby tender the sum of \$....., which I request be accepted in compromise of the specific penalty only.

(Signed).....

(Address).....

Subscribed and sworn to before me
this.....day of.....
192.....

(Official title)

If remittance is made by check, same must be certified and made payable to the State Comptroller.

TO THE STATE TAX DEPARTMENT
ALBANY, N. Y.

IN RE
Name of Corporation)

(P. O. Address).....

STATE OF.....

COUNTY OF

.....being duly sworn, says that he is a
resident of and that he is the
.....of the
a corporation organized under the laws of.....; that said
corporation ceased business in the State of New York not later than....., 19...;
that the entire assets of said corporation in New York State were disposed of not later than
....., 19..., through (*).....; that no property or
place of business is, or will be, maintained within New York State.

If the assets were acquired by another corporation give the name of the acquiring cor-
poration

Deponent further says that this affidavit is made for the purpose of having the name of
the corporation eliminated from the list of those required to file annual returns under Article
9-A of the Tax Law, and that he realizes that the obligation to secure blanks and make return
is assumed by the corporation in event of its ownership of any property located within New
York State or the maintenance of a place of business therein.

.....
(Signature of corporate officer)

.....
(Official title)

Subscribed and sworn to before me,
this.....day of.....192....

.....
Notary Public.

(*) Use such terms as "removal, sale, foreclosure, assignment, merger, forfeiture, condemnation,
consolidation, dissolution, etc."

TO THE STATE TAX DEPARTMENT

File No.....

ALBANY, N. Y.

IN RE.....
(Name of Corporation)

(P. O. Address).....

STATE OF.....

COUNTY OF.....

.....being duly sworn, says that he is a resident of..... and that he was the last elected and acting..... of the..... a corporation organized under the laws of.....; that said corporation ceased business not later than.....191....; that the entire assets of said corporation were disposed of not later than.....191....; through (*).....; that the charter has been abandoned and the corporation does not contemplate resuming operations under said charter.

If the assets were acquired by another corporation give the name of the acquiring corporation.....

Deponent further says that this affidavit is made for the purpose of having the name of the corporation eliminated from the list of those required to file annual returns under §..... of the tax law, and he realizes that the obligation to secure blanks and make return is assumed by the corporation in event operations are resumed under its charter.

.....
(Signature of corporate officer)

.....
(Official title)

Subscribed and sworn to before me,
this.....day of.....191....

.....
(Official capacity)

(*) Use such terms as "sale, foreclosure assignment, merger, forfeiture, condemnation, consolidation, dissolution, etc."

APPENDIX B

COURT DECISIONS

TRAVIS V. YALE AND TOWNE MANUFACTURING COMPANY

Decision of District Court, Southern District of New York,
affirmed March 1, 1920.

(Decision.)

Supreme Court of the United States.

252 U. S. 60.

Eugene M. Travis, as Comptroller of the State of New York, Appellant, vs. The Yale & Towne Manufacturing Company	} Appeal from the District Court of the United States for the Southern District of New York.
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Mr. Justice PITNEY delivered the opinion of the Court.

This was a suit in equity, brought in the District Court by appellee against appellant as Comptroller of the State of New York to obtain an injunction restraining the enforcement of the Income Tax Law of that State (Chap. 627, Laws of 1919) as against complainant, upon the ground of its repugnance to the Constitution of the United States because violating the interstate commerce clause, impairing the obligation of contracts, depriving citizens of the States of Connecticut and New Jersey employed by complainant of the privileges and immunities enjoyed by citizens of the State of New York, depriving complainant and its non-resident employees of their property without due process of law, and denying to such employees the equal protection of the laws. A motion to dismiss the bill—equivalent to a demurrer—was denied upon the ground that the Act violated sec. 2 of Art. IV of the Constitution by discriminating against non-residents in the exemptions allowed from taxable income; an answer was filed, raising no question of fact; in due course there was a final decree in favor of complainant; and defendant took an appeal to this court under sec. 238 Judicial Code.

The Act (sec. 351) imposes an annual tax upon every resident of the State with respect to his net income as defined in the Act, at specified rates, and provides also: "A like tax is hereby imposed and shall be levied, collected and paid annually, at the rates specified in this section, upon and with respect to the entire net income as herein defined, except as hereinafter provided, from all property owned and from every business, trade, profession or occupation carried on in this State by natural

persons not residents of the State." Sec. 359 defines gross income, and contains this paragraph: "3. In the case of taxpayers other than residents, gross income includes only the gross income from sources within the State, but shall not include annuities, interest on bank deposits, interest on bonds, notes or other interest-bearing obligations or dividends from corporations, except to the extent to which the same shall be a part of income from any business, trade, profession or occupation carried on in this State subject to taxation under this article." In sec. 360 provision is made for deducting in the computation of net income expenses, taxes, losses, depreciation charges, etc.; but, by paragraph 11 of the same section. "In the case of a taxpayer other than a resident of the State the deductions allowed in this section shall be allowed only if, and to the extent that, they are connected with income arising from sources within the State; By sec. 362 certain exemptions are allowed to any resident individual taxpayer, viz., in the case of a single person a personal exemption of \$1,000, in the case of the head of a family or a married person living with husband or wife, \$2,000; and \$200 additional for each dependent person under 18 years of age or mentally or physically defective. The next section reads as follows: "Sec. 363. Credit for taxes in case of taxpayers other than residents of the State. Whenever a taxpayer other than a resident of the State has become liable to income tax to the State or country where he resides upon his net income for the taxable year, derived from sources within this State and subject to taxation under this article, the comptroller shall credit the amount of income tax payable by him under this article with such proportion of the tax so payable by him to the State or country where he resides as his income subject to taxation under this article bears to his entire income upon which the tax so payable to such other State or country was imposed; provided that such credit shall be allowed only if the laws of said State or country grant a substantially similar credit to residents of this State subject to income tax under such laws." Sec. 366 in terms requires that every "withholding agent" (including employers) shall deduct and withhold 2 per centum from all salaries, wages, etc., payable to non-residents, where the amount paid to any individual equals or exceeds \$1,000 in the year, and shall pay the tax to the Comptroller. This applies to a resident employee, also, unless he files a certificate showing his residence address within the State.

Complainant, a Connecticut corporation doing business in New York and elsewhere, has employees who are residents some of Connecticut others of New Jersey but are occupied in whole or in part in complainant's business in New York. Many of them have annual salaries or fixed compensation exceeding \$1,000 per year, and the amount required by the Act to be withheld by complainant from the salaries of such non-resident employees is in excess of \$3,000 per year. Most of these persons are engaged under term contracts calling for stipulated wages or salaries for a specified period.

The bill sets up that defendant, as Comptroller of the State of New York, threatens to enforce the provisions of the Statute against complainant, requires it to deduct and withhold from the salaries and wages payable to its employees residing in Connecticut or New Jersey and citizens of those States respectively, engaged in whole or in part in complainant's business in the State of New York, the taxes provided in the statute, and threatens to enforce against complainant the penalties provided by the Act if it fails to do so; that the Act is unconstitutional for the reasons above specified; and that if complainant does withhold the taxes as required it will be subjected to many actions by its employees for reimbursement of the sums so withheld. No question is made about complainant's right to resort to equity for relief; hence we come at once to the constitutional questions.

That the State of New York has jurisdiction to impose a tax of this kind upon the incomes of non-residents arising from any business, trade, profession, or occupation carried on within its borders, enforcing payment so far as it can by the exercise of a just control over persons and property within the State, as by garnishment of credits (of which the withholding provision of the New York law is the practical equivalent); and that such a tax, so enforced, does not violate the due process of law provision of the Fourteenth Amendment, is settled by our decision in *Shaffer v. Carter, State Auditor*, this day announced, involving the income tax law of the State of Oklahoma. That there is no unconstitutional discrimination against citizens of other States in confining the deduction of expenses, losses, etc., in the case of nonresident taxpayers to such as are connected with income arising from sources within the taxing State, likewise is settled by that decision.

It is not here asserted that the tax is a burden upon interstate commerce; the point having been abandoned in this court.

The contention that an unconstitutional discrimination against non-citizens arises out of the provision of sec. 366 confining the withholding at source to the income of non-residents is unsubstantial. That provision does not in any wise increase the burden of the tax upon non-residents, but merely recognizes the fact that as to them the State imposes no personal liability, and hence adopts a convenient substitute for it. See *Bell's Gap Railroad Co. v. Pennsylvania*, 134 U. S. 232, 239.

Nor has complainant on its own account any just ground of complaint by reason of being required to adjust its system of accounting and paying salaries and wages to the extent required to fulfill the duty of deducting and withholding the tax. This cannot be deemed an unreasonable regulation of its conduct of business in New York. *Erie Railroad v. Pennsylvania*, 153 U. S. 628 cited in behalf of complainant, is not in point. In that case the State of Pennsylvania granted to a railroad company organized under the laws of New York and having its principal place of business in that State the right to construct a portion of its road through Pennsylvania, upon prescribed terms which were assented to and com-

plied with by the company and were deemed to constitute a contract, not subject to impairment or modification through subsequent legislation by the State of Pennsylvania except to the extent of establishing reasonable regulations touching the management of the business done and the property owned by the company in that State, not materially interfering with or obstructing the substantial enjoyment of the rights previously granted. Afterwards, Pennsylvania undertook by statute to require the company, when making payment of coupons upon bonds previously issued by it, payable at its office in the City of New York, to withhold taxes assessed by the State of Pennsylvania against residents of that State because of ownership of such bonds. The coupons were payable to bearer, and when they were presented for payment it was practically impossible for the company to ascertain who were the real owners, or whether they were owned by the same parties who owned the bonds. The statute was held to be an unreasonable regulation and hence to amount to an impairment of the obligation of the contract.

In the case at bar, complainant, although it is a Connecticut corporation and has its principal place of business in that State, is exercising the privilege of carrying on business in the State of New York without any contract limiting the State's power of regulation. The taxes required to be withheld are payable with respect to that portion only of the salaries of its employees which is earned within the State of New York. It might pay such salaries, or this portion of them, at its place of business in New York; and the fact that it may be more convenient to pay them in Connecticut is not sufficient to deprive the State of New York of the right to impose such a regulation. It is true complainant asserts that the Act impairs the obligation of contracts between it and its employees; but there is no averment that any such contract made before the passage of the Act required the wages or salaries to be paid in the State of Connecticut, or contained other provisions in anywise conflicting with the requirement of withholding.

The District Court, not passing upon the above questions, held that the Act, in granting to residents exemptions denied to non-residents, violated the provisions of sec. 2 of Art. IV of the federal Constitution: "The Citizens of each State shall be entitled to all Privileges and Immunities of Citizens in the several States"; and, notwithstanding the elaborate and ingenious argument submitted by appellant to the contrary, we are constrained to affirm the ruling.

The purpose of the provision came under consideration in *Paul v. Virginia*, 8 Wall. 168, 180, where the court, speaking of Mr. Justice Field, said: "It was undoubtedly the object of the clause in question to place the citizens of each State upon the same footing with citizens of other States, so far as the advantages resulting from citizenship in those States are concerned. It relieves them from the disabilities of alienage in other States; it inhibits discriminating legislation against them by other States; it gives them the right of free ingress into other States, and

egress from them; it insures to them in other States the same freedom possessed by the citizens of those States in the acquisition and enjoyment of property and in the pursuit of happiness; and it secures to them in other States the equal protection of their laws. It has been justly said that no provision in the Constitution has tended so strongly to constitute the citizens of the United States one people as this." And in *Ward v. Maryland*, 12 Wall. 418, holding a discriminatory State tax upon non-resident traders to be void, the court, by Mr. Justice Clifford, said (p. 430): "Beyond doubt those words [privileges and immunities] are words of very comprehensive meaning, but it will be sufficient to say that the clause plainly and unmistakably secures and protects the right of a citizen of one State to pass into any other State of the Union for the purpose of engaging in lawful commerce, trade, or business without molestation; to acquire personal property; to take and hold real estate; to maintain actions in the courts of the State; and to be exempt from any higher taxes or excises than are imposed by the State upon its own citizens."

Of course the terms "resident" and "citizen" are not synonymous, and in some cases the distinction is important (*La Tourette v. McMaster*, 248 U. S. 465, 470); but a general taxing scheme such as the one under consideration, if it discriminates against all non-residents, has the necessary effect of including in the discrimination those who are citizens of other States; and, if there be no reasonable ground for the diversity of treatment, it abridges the privileges and immunities to which such citizens are entitled. In *Blake v. McClung*, 172 U. S. 239, 247; 176 U. S. 59, 67, the court held that a statute of Tennessee, declaring the terms upon which a foreign corporation might carry on business and hold property in that State, which gave to its creditors residing in Tennessee priority over all creditors residing elsewhere, without special reference to whether they were citizens or not, must be regarded as contravening the "privileges and immunities" clause.

The nature and effect of the crucial discrimination in the present case are manifest. Sec. 362 in the case of residents, exempts from taxation \$1,000 of the income of a single person, \$2,000 in the case of a married person, and \$200 additional for each dependent. A non-resident taxpayer has no similar exemption; but by sec. 363, if liable to an income tax in his own State, including income derived from sources within New York and subject to taxation under this Act, he is entitled to a credit upon the income tax otherwise payable to the State of New York by the same proportion of the tax payable to the State of his residence as his income subject to taxation by the New York Act bears to his entire income taxed in his own State; "provided, that such credit shall be allowed only if the laws of said State . . . grant a substantially similar credit to residents of this State subject to income tax under the laws."

In the concrete, the particular incidence of the discrimination is upon citizens of Connecticut and New Jersey, neither of which States has an income tax law. A considerable number of complainant's employees,

residents and citizens of one or the other of those States, spend their working time at its office in the city of New York, and earn their salaries there. The case is typical; it being a matter of common knowledge that from necessity, due to the geographical situation of that city, in close proximity to the neighboring States, many thousands of men and women, residents and citizens of those States, go daily from their homes to the city and earn their livelihood there. They pursue their several occupations side by side with residents of the State of New York—in effect competing with them as to wages, salaries, and other terms of employment. Whether they must pay a tax upon the first \$1,000 or \$2,000 of income, while their associates and competitors who reside in New York do not, makes a substantial difference. Under the circumstances as disclosed, we are unable to find adequate ground for the discrimination, and are constrained to hold that it is an unwarranted denial to the citizens of Connecticut and New Jersey of the privileges and immunities enjoyed by citizens of New York. This is not a case of occasional or accidental inequality due to circumstances personal to the taxpayer (see *Amoskeag Savings Bank v. Purdy*, 231 U. S. 373, 393-394; *Maxwell v. Bugbee*, 250 U. S. 525, 543); but a general rule, operating to the disadvantage of all non-residents including those who are citizens of the neighboring States, and favoring all residents including those who are citizens of the taxing State.

It cannot be deemed to be counterbalanced by the provision of par. 3 of sec. 359 which excludes from the income of non-resident taxpayers "annuities, interest on bank deposits, interest on bonds, notes, or other interest-bearing obligations or dividends from corporations, except to the extent to which the same shall be a part of income from any business, trade, profession or occupation carried on in this State subject to taxation under this article." This provision is not so conditioned as probably to benefit non-residents to a degree corresponding to the discrimination against them; it seems to have been designed rather (as is avowed in appellant's brief) to preserve the preeminence of New York City as a financial center.

Nor can the discrimination be upheld, as is attempted to be done, upon the theory that non-residents have untaxed income derived from sources in their home States or elsewhere outside of the State of New York, corresponding to the amount upon which residents of that State are exempt from taxation under this Act. The discrimination is not conditioned upon the existence of such untaxed income; and it would be rash to assume that non-residents taxable in New York under this law, as a class, are receiving additional income from outside sources equivalent to the amount of the exemptions that are accorded to citizens of New York and denied to them.

In the brief submitted by the Attorney-General of New York in behalf of appellant, it is said that the framers of the Act, in embodying in it the provision for unequal treatment of the residents of other States with respect

of

to the exemptions, looked forward to the speedy adoption of an income tax by the adjoining States; in which event, injustice to their citizens on the part of New York could be avoided by providing similar exemptions similarly conditioned. This, however, is wholly speculative; New York has no authority to legislate for the adjoining States; and we must pass upon its statute with respect to its effect and operation in the existing situation. But besides, in view of the provisions of the Constitution of the United States, a discrimination by the State of New York against the citizens of adjoining States would not be cured were those States to establish like discriminations against citizens of the State of New York. A State may not barter away the right, conferred upon its citizens by the Constitution of the United States, to enjoy the privileges and immunities of citizens when they go into other States. Nor can discrimination be corrected by retaliation; to prevent this was one of the chief ends sought to be accomplished by the adoption of the Constitution. Decree affirmed.

Mr. Justice McReynolds concurs in the result.

SHAFFER V. CARTER

Decided March 1, 1920

(Decision.)

Supreme Court of the United States.

(252 U. S. 37)

Mr. Justice PITNEY delivered the opinion of the Court.

These are two appeals, taken under circumstances that will be explained, from a single decree in a suit in equity brought by appellant to restrain the enforcement of a tax assessed against him for the year 1916 under the Income Tax Law of the State of Oklahoma, on the ground of the unconstitutionality of the statute.

A previous suit having the same object was brought by him in the same court against the officials then in office, in which an application for an interlocutory injunction heard before three judges pursuant to sec. 266 Judicial Code was denied, one judge dissenting. *Shaffer v. Howard*, 250 Fed. Rep. 873. An appeal was taken to this court, but, pending its determination, the terms of office of the defendants expired, and, there being no law of the State authorizing a revival or continuance of the action against their successors, we reversed the decree and remanded the cause with directions to dismiss the bill for want of proper parties. 249 U. S. 200.

After such dismissal the present defendant Carter, as State Auditor, issued another tax warrant and delivered it to defendant Bruce, Sheriff of Creek County, with instructions to levy upon and sell plaintiff's property in that county in order to collect the tax in question; and the sheriff having threatened to proceed, this suit was commenced. An application for an interlocutory injunction, heard before three judges, was denied upon the authority of the decision in 250 Fed. Rep. and of certain recent decisions of this court. The decree as entered not only disposed of the application but dismissed the action. Plaintiff, apparently unaware of this, appealed to this court under sec. 266 Judicial Code from the refusal of the temporary injunction. Shortly afterwards he took an appeal under sec. 238 Judicial Code from the same decree as a final decree dismissing the action. The latter appeal is in accord with correct practice, since the denial of the interlocutory application was merged in the final decree. The first appeal (No. 531) will be dismissed.

The Constitution of Oklahoma, besides providing for the annual taxation of all property in the State upon an *ad valorem* basis, authorizes (Art. 10, sec. 12) the employment of a variety of other means for raising revenue, among them income taxes.

The act in question is Ch. 164 of the laws of 1915. Its first section reads as follows: "Each and every person in this State, shall be liable to an annual tax upon the entire net income of such person arising or accruing from all sources during the preceding calendar year, and a like tax shall be levied, assessed, collected and paid annually upon the entire net income from all property owned, and of every business, trade or profession carried on in this State by persons residing elsewhere." Subsequent sections define what the term "income" shall include; prescribe how net income shall be computed; provide for certain deductions; prescribe varying rates of tax for all taxable incomes in excess of \$3,000, this amount being deducted (by way of exemption) from the income of each individual, and for one living with spouse an additional \$1,000, with further deductions where there are children or dependents, exemptions being the same for residents and non-residents; require (sec. 2) a return on or before March first from each person liable for an income tax under the provisions of the Act for the preceding calendar year; provide (sec. 9) that the State Auditor shall revise returns and hear and determine complaints, with power to correct and adjust the assessment of income; that (sec. 10) taxes shall become delinquent if not paid on or before the first day of July, and the State Auditor shall have power to issue to any sheriff of the State a warrant commanding him to levy the amount upon the personal property of the delinquent party; and (by sec. 11) "If any of the taxes herein levied become delinquent, they shall become a lien on all the property, personal and real, of such delinquent person, and shall be subject to the same penalties and provisions as are all *ad valorem* taxes."

Plaintiff, a non-resident of Oklahoma, being a citizen of Illinois and a resident of Chicago in that State, was at the time of the commencement of the suit and for several years theretofore (including the years 1915 and 1916) engaged in the oil business in Oklahoma, having purchased, owned, developed, and operated a number of oil and gas mining leases, and being the owner in fee of certain oil-producing land, in that State. From properties thus owned and operated during the year 1916 he received a net income exceeding \$1,500,000, and of this he made, under protest, a return which showed that, at the rates fixed by the Act, there was due to the State an income tax in excess of \$76,000. The then State Auditor overruled the protest and assessed a tax in accordance with the return; the present Auditor has put it in due course of collection; and plaintiff resists its enforcement upon the ground that the Act, in so far as it subjects the incomes of non-residents to the payment of such a tax, takes their property without due process of law and denies to them the equal protection of the laws, in contravention of sec. 1 of the Fourteenth Amendment; burdens interstate commerce, in contravention of the commerce clause of sec. 8 of Art. 1 of the Constitution; and discriminates against non-residents in favor of residents, and thus deprives plaintiff and other non-residents of the privileges and immunities of citizens and residents of the State of Oklahoma, in violation of sec. 2 of Art. IV. He also insists

that the lien attempted to be imposed upon his property pursuant to sec. 11 for taxes assessed upon income not arising out of the same property would deprive him of property without due process of law.

As ground for resorting to equity, the bill alleges that plaintiff is the owner of various oil and gas mining leases covering lands in Creek County, Oklahoma, and that the lien asserted thereon by virtue of the levy and tax warrant creates a cloud upon his title. This entitles him to bring suit in equity (*Union Pacific Ry. Co. v. Cheyenne*, 113 U. S. 516, 525; *Pacific Express Co. v. Seibert*, 142 U. S. 339, 348; *Ogden City v. Armstrong*, 168 U. S. 224, 237; *Ohio Tax Cases*, 232 U. S. 576, 587; *Greene v. Louisville & Interurban R. R. Co.*, 244 U. S. 499, 506), unless the contention that he has a plain, adequate, and complete remedy at law be well founded.

This contention is based, first, upon the provision of sec. 9 of Chap. 164, giving to the State Auditor the same power to correct and adjust an assessment of income that is given to the county board of equalization in cases of *ad valorem* assessments, taken in connection with Chap. 107 of the Laws of 1915, which provides (Art. 1, Subdiv. B, sec. 2, p. 147) for an appeal from that board to the district court of the county. In a recent decision (*Berryhill v. Carter*, 185 Pac. Rep. 93), the supreme court of the State held that an aggrieved income taxpayer may have an appeal under this section, and that thus "all matters complained of may be reviewed and adjusted to the extent that justice may demand." But the case related to "correcting and adjusting an income tax return", and the decision merely established the appeal to the district court as the appropriate remedy, rather than an application to the supreme court for a writ of certiorari. It falls short of indicating—to say nothing of plainly showing—that this procedure would afford an adequate remedy to a party contending that the income tax law itself was repugnant to the Constitution of the United States.

Secondly, reference is made to sec. 7 of Subdiv. B, Art. 1, of Chap. 107, Oklahoma Laws 1915, p. 149, wherein it is provided that where illegality of a tax is alleged to arise by reason of some action from which the laws provide no appeal, the aggrieved person on paying the tax may give notice to the officer collecting it, stating the grounds of complaint and that suit will be brought against him; whereupon it is made the duty of such officer to hold the tax until the final determination of such suit if brought within thirty days; and if it be determined that the tax was illegally collected, the officer is to repay the amount found to be in excess of the legal and correct amount. But this section is one of several that have particular reference to the procedure for collecting *ad valorem* taxes; and they are prefaced by this statement (p. 147): "Subdivision B. To the existing provisions of law relating to the *ad valorem* or direct system of taxation the following provisions are added:" Upon this ground, in *Gypsy Oil Co. v. Howard* and companion suits brought by certain oil-producing companies to restrain enforcement of taxes authorized by the

gross production tax law (Sess. Laws 1916, p. 102), upon the ground that they were an unlawful imposition upon federal instrumentalities, the United States District Court for the Western District of Oklahoma held that the legal remedy provided in section 7 of Chap. 107 applied only to *ad valorem* taxes, and did not constitute a bar to equitable relief against the production taxes. Defendants appealed to this court, and assigned this ruling for error, *inter alia*; but they did not press the point, and the decrees were affirmed upon the merits of the federal question. *Howard v. Gypsy Oil Co.*, 247 U. S. 503.

We deem it unnecessary to pursue further the question whether either of the statutory provisions referred to furnishes an adequate legal remedy against income taxes assessed under an unconstitutional law, since one of the grounds of complaint in the present case is that, even if the tax itself be valid, the procedure prescribed by sec. 11 of the Income Tax Law for enforcing such a tax by imposing a lien upon the taxpayer's entire property, as threatened to be put into effect against plaintiff's property for taxes not assessed against the property itself and not confined to the income that proceeded from the same property, is not "due process of law," within the requirement of the Fourteenth Amendment. For removal of a cloud upon title caused by an invalid lien imposed for a tax valid in itself, there appears to be no legal remedy. Hence, on this ground at least, resort was properly had to equity for relief; and since a court of equity does not "do justice by halves," and will prevent, if possible, a multiplicity of suits, the jurisdiction extends to the disposition of all questions raised by the bill. *Camp v. Boyd*, 229 U. S. 530, 551-552; *McGowan v. Parish*, 237 U. S. 285, 296.

This brings us to the merits.

Under the "due process of law" provision appellant makes two contentions: first, that the State is without jurisdiction to levy a tax upon the income of non-residents; and, secondly, that the lien is invalid because imposed upon all his property real and personal, without regard to its relation to the production of his income.

These are separate questions, and will be so treated. The tax might be valid, although the measures adopted for enforcing it were not. Governmental jurisdiction in matters of taxation, as in the exercise of the judicial function, depends upon the power to enforce the mandate of the State by action taken within its borders, either *in personam* or *in rem* according to the circumstances of the case, as by arrest of the person, seizure of goods or lands, garnishment of credits, sequestration of rents and profits, forfeiture of franchise, or the like; and the jurisdiction to act remains even though all permissible measures be not resorted to. *Michigan Trust Co. v. Ferry*, 228 U. S. 346, 353; *Ex parte Indiana Transportation Co.*, 244 U. S. 456, 457.

It will be convenient to postpone the question of the lien until all questions as to the validity of the tax have been disposed of.

The contention that a State is without jurisdiction to impose a tax upon the income of non-residents, while raised in the present case, was more emphasized in *Travis, Comptroller v. Yale & Towne Mfg. Co.*, decided this day, involving the income tax law of the State of New York. There it was contended, in substance, that while a State may tax the property of a non-resident situate within its borders, or may tax the incomes of its own citizens and residents because of the privileges they enjoy under its constitution and laws and the protection they receive from the State, yet a non-resident, although conducting a business or carrying on an occupation there, cannot be required through income taxation to contribute to the governmental expenses of the State whence his income is derived; that an income tax, as against non-residents, is not only not a property tax but is not an excise or privilege tax, since no privilege is granted; the right of the non-citizen to carry on his business or occupation in the taxing State being derived, it is said, from the provisions of the federal Constitution.

This radical contention is easily answered by reference to fundamental principles. In our system of government the States have general dominion, and, saving as restricted by particular provisions of the federal Constitution, complete dominion over all persons, property, and business transactions within their borders; they assume and perform the duty of preserving and protecting all such persons, property, and business, and, in consequence, have the power normally pertaining to governments to resort to all reasonable forms of taxation in order to defray the governmental expenses. Certainly they are not restricted to property taxation, nor to any particular form of excises. In well-ordered society, property has value chiefly for what it is capable of producing, and the activities of mankind are devoted largely to making recurrent gains from the use and development of property, from tillage, mining, manufacture, from the employment of human skill and labor, or from a combination of some of these; gains capable of being devoted to their own support, and the surplus accumulated as an increase of capital. That the State, from whose laws property and business and industry derive the protection and security without which production and gainful occupation would be impossible, is debarred from exacting a share of those gains in the form of income taxes for the support of the government, is a proposition so wholly inconsistent with fundamental principles as to be refuted by its mere statement. That it may tax the land but not the crop, the tree but not the fruit, the mine or well but not the product, the business but not the profit derived from it, is wholly inadmissible.

Income taxes are a recognized method of distributing the burdens of government, favored because requiring contributions from those who realize current pecuniary benefits under the protection of the government, and because the tax may be readily proportioned to their ability to pay. Taxes of this character were imposed by several of the States at or shortly after the adoption of the federal Constitution. New York Laws

1778, Chap. 17; Report of Oliver Wolcott, Jr., Secretary of the Treasury, to 4th Congress, 2nd Sess. (1796), concerning Direct Taxes; American State Papers, 1 Finance 423, 427, 429, 437, 439.

The rights of the several States to exercise the widest liberty with respect to the imposition of internal taxes always has been recognized in the decisions of this court. In *McCulloch v. Maryland*, 4 Wheat. 316, while denying their power to impose a tax upon any of the operations of the federal Government, Mr. Chief Justice Marshall, speaking for the court, conceded (pp. 428-429) that the States have full power to tax their own people and their own property, and also that the power is not confined to the people and property of a State, but may be exercised upon every object brought within its jurisdiction; saying: "It is obvious, that it is an incident of sovereignty, and is co-extensive with that to which it is an incident. All subjects over which the sovereign power of a State extends, are objects of taxation," etc. In *Michigan Central Railroad v. Powers*, 201 U. S. 245, the court, by Mr. Justice Brewer, said (pp. 292, 293): "We have had frequent occasion to consider questions of state taxation in the light of the federal Constitution, and the scope and limits of national interference are well settled. There is no general supervision on the part of the Nation over state taxation, and in respect to the latter the State has, speaking generally, the freedom of a sovereign both as to objects and methods." That a State may tax callings and occupations as well as persons and property has long been recognized. "The power of taxation, however vast in its character and searching in its extent, is necessarily limited to subjects within the jurisdiction of the State. These subjects are persons, property, and business. . . . It [taxation] may touch business in the almost infinite forms in which it is conducted, in professions, in commerce, in manufactures, and in transportation. Unless restrained by provisions of the federal Constitution, the power of the State as to the mode, form, and extent of taxation is unlimited, where the subjects to which it applies are within her jurisdiction." *State Tax on Foreign-Held Bonds*, 15 Wall. 300, 319. See also *Welton v. Missouri*, 91 U. S. 275, 278; *Armour & Co. v. Virginia*, 246 U. S. 1, 6; *American Mfg. Co. v. St. Louis*, 250 U. S. 459, 463.

That a State, consistently with the federal Constitution, may not prohibit the citizens of other States from carrying on legitimate business within its borders like its own citizens, of course is granted; but it does not follow that the business of non-residents may not be required to make a ratable contribution in taxes for the support of the government. On the contrary, the very fact that a citizen of one State has the right to hold property or carry on an occupation or business in another is a very reasonable ground for subjecting such non-resident, although not personally yet to the extent of his property held, or his occupation or business carried on therein, to a duty to pay taxes not more onerous in effect than those imposed under like circumstances upon citizens of the latter State. Sec. 2 of Art. IV of the Constitution entitles him to the privileges and

immunities of a citizen, but no more; not to an entire immunity from taxation, nor to any preferential treatment as compared with resident citizens. It protects him against discriminatory taxation, but gives him no right to be favored by discrimination or exemption. See *Ward v. Maryland*, 12 Wall. 418, 430.

Oklahoma has assumed no power to tax non-residents with respect to income derived from property or business beyond the borders of the State. The first section of the act, while imposing a tax upon inhabitants with respect to their entire net income arising from all sources, confines the tax upon non-residents to their net income from property owned and business, etc., carried on within the State. A similar distinction has been observed in our federal income tax laws, from one of the earliest down to the present.* The acts of 1861 (12 Stat. 309) and 1864 (13 Stat. 281, 417) confined the tax to persons residing in the United States and citizens residing abroad. But in 1866 (14 Stat. 137-138) there was inserted by amendment the following: "And a like tax shall be levied, collected, and paid annually upon the gains, profits, and income of every business, trade, or profession carried on in the United States by persons residing without the United States, not citizens thereof." Similar provisions were embodied in the Acts of 1870 and 1894; and in the Act of 1913 (38 Stat. 166), after a clause imposing a tax upon the entire net income arising or accruing from all sources (with exceptions not material here) to every citizen of the United States, whether residing at home or abroad, and to every person residing in the United States though not a citizen thereof, the following appears: "and a like tax shall be assessed, levied, collected, and paid annually upon the entire net income from all property owned and of every business, trade, or profession carried on in the United States by persons residing elsewhere." Evidently this furnished the model for sec. 1 of the Oklahoma statute.

No doubt is suggested (the former requirement of apportionment having been removed by constitutional amendment) as to the power of Congress thus to impose taxes upon incomes produced within the borders of the United States or arising from sources located therein, even though the income accrues to a non-resident alien. And, so far as the question of jurisdiction is concerned, the due process clause of the Fourteenth Amendment imposes no greater restriction in this regard upon the several States than the corresponding clause of the Fifth Amendment imposes upon the United States.

*Acts of August 5, 1861 (Ch. 45, sec. 49; 12 Stat. 292, 309); June 30, 1864 (Ch. 173, sec. 116; 13 Stat. 223, 281); July 4, 1864 (Joint Res. 77; 13 Stat. 417); July 13, 1866 (Ch. 184, sec. 9; 14 Stat. 98, 137-138); March 2, 1867 (Ch. 169, sec. 13; 14 Stat. 471, 477-478); July 14, 1870 (Ch. 255, sec. 6; 16 Stat. 256, 257); August 27, 1894 (Ch. 349, sec. 27; 28 Stat. 509, 533); October 3, 1913 (Ch. 16, sec. II, A. Subd. 1; 38 Stat. 114, 166); September 8, 1916 (Ch. 463, Title I, Part I, sec. 1, a; 39 Stat. 756); October 3, 1917 (Ch. 63, Title I, Part I, sec. 1, and 2; 40 Stat. 300); February 24, 1919 (Ch. 18, secs. 210, 213 (c); 40 Stat. 1057, 1062, 1066).

It is insisted, however, both by appellant in this case and by the opponents of the New York law in *Travis, Comptroller, v. Yale & Towne Mfg. Co.*, that an income tax is in its nature a personal tax, or a "subjective tax imposing personal liability upon the recipient of the income"; and that as to a non-resident the State has no jurisdiction to impose such a liability. This argument, upon analysis, resolves itself into a mere question of definitions, and has no legitimate bearing upon any question raised under the federal Constitution. For, where the question is whether a state taxing law contravenes rights secured by that instrument, the decision must depend not upon any mere question of form, construction, or definition, but upon the practical operation and effect of the tax imposed. *St. Louis S. W. Ry. v. Arkansas*, 235 U. S. 350, 362; *Mountain Timber Co. v. Washington*, 243 U. S. 219, 237; *Crew Levick Co. v. Pennsylvania*, 245 U. S. 292, 294; *American Mfg. Co. v. St. Louis*, 250 U. S. 459, 463. The practical burden of a tax imposed upon the net income derived by a non-resident from a business carried on within the State certainly is no greater than that of a tax upon the conduct of the business, and this the State has the lawful power to impose, as we have seen.

The fact that it required the personal skill and management of appellant to bring his income from producing property in Oklahoma to fruition, and that his management was exerted from his place of business in another State, did not deprive Oklahoma of jurisdiction to tax the income which arose within its own borders. The personal element cannot, by any fiction, oust the jurisdiction of the State within which the income actually arises and whose authority over it operates *in rem*. At most, there might be a question whether the value of the service of management rendered from without the State ought not to be allowed as an expense incurred in producing the income; but no such question is raised in the present case, hence we express no opinion upon it.

The contention that the Act deprives appellant and others similarly circumstanced of the privileges and immunities enjoyed by residents and citizens of the State of Oklahoma, in violation of sec. 2 of Art. IV of the Constitution, is based upon two grounds, which are relied upon as showing also a violation of the "equal protection" clause of the Fourteenth Amendment.

One of the rights intended to be secured by the former provision is that a citizen of one State may remove to and carry on business in another without being subjected in property or person to taxes more onerous than the citizens of the latter State are subjected to. *Paul v. Virginia*, 8 Wall. 168, 180; *Ward v. Maryland*, 12 Wall. 418, 430; *Maxwell v. Bugbee*, 250 U. S. 525, 537. The judge who dissented in *Shaffer v. Howard*, 250 Fed. Rep. 873, 883, concluded that the Oklahoma income tax law offended in this regard, upon the ground (p. 888) that since the tax is as to citizens of Oklahoma a purely personal tax measured by their incomes, while as applied to a non-resident it is "essentially a tax upon his property and

business within the State, to which the property and business of citizens and residents of the State are not subjected", there was a discrimination against the non-resident. We are unable to accept this reasoning. It errs in paying too much regard to theoretical distinctions and too little to the practical effect and operation of the respective taxes as levied; in failing to observe that in effect citizens and residents of the State are subjected at least to the same burden as non-residents, and perhaps to a greater, since the tax imposed upon the former includes all income derived from their property and business within the State and, in addition, any income they may derive from outside sources.

Appellant contends that there is a denial to non-citizens of the privileges and immunities to which they are entitled, and also a denial of the equal protection of the laws, in that the Act permits residents to deduct from their gross income not only losses incurred within the state of Oklahoma but also those sustained outside of that State, while non-residents may deduct only those incurred within the State. The difference, however, is only such as arises naturally from the extent of the jurisdiction of the State in the two classes of cases, and cannot be regarded as an unfriendly or unreasonable discrimination. As to residents it may, and does, exert its taxing power over their income from all sources, whether within or without the State and it accords to them a corresponding privilege of deducting their losses, wherever these accrue. As to non-residents, the jurisdiction extends only to their property owned within the State and their business, trade, or profession carried on therein, and the tax is only on such income as is derived from those sources. Hence there is no obligation to accord to them a deduction by reason of losses elsewhere incurred. It may be remarked, in passing, that there is no showing that appellant has sustained such losses, and so he is not entitled to raise this question.

It is urged that, regarding the tax as imposed upon the business conducted within the State, it amounts in the case of appellant's business to a burden upon interstate commerce, because the products of his oil operations are shipped out of the State. Assuming that it fairly appears that his method of business constitutes interstate commerce, it is sufficient to say that the tax is imposed not upon the gross receipts, as in *Crew Levick Co. v. Pennsylvania*, 245 U. S. 292, but only upon the net proceeds, and is plainly sustainable even if it includes net gains from interstate commerce. *U. S. Glue Co. v. Oak Creek*, 247 U. S. 321. Compare *Peck & Co. v. Lowe*, 247 U. S. 165.

Reference is made to the gross production tax law of 1915 (Chap. 107, Art. 2, subdiv. A, sec. 1; Sess. Laws 1915, p. 151), as amended by Chap. 39 of Sess. Laws 1916 (p. 104), under which every person or corporation engaged in producing oil or natural gas within the State is required to pay a tax equal to 3 per centum of the gross value of such product in lieu of all taxes imposed by the State, counties, or municipalities upon the land or the leases, mining rights, and privileges, and the machinery,

appliances, and equipment, pertaining to such production. It is contended that payment of the gross production tax relieves the producer from the payment of the income tax. This is a question of state law, upon which no controlling decision by the supreme court of the State is cited. We overrule the contention, deeming it clear, as a matter of construction, that the gross production tax was intended as a substitute for the *ad valorem* property tax but not for the income tax, and that here is no such repugnance between it and the income tax as to produce a repeal by implication. Nor, even if the effect of this is akin to double taxation, can it be regarded as obnoxious to the federal Constitution for that reason, since it is settled that nothing in that instrument or in the Fourteenth Amendment prevents the States from imposing double taxation, or any other form of unequal taxation, so long as the inequality is not based upon arbitrary distinctions. *St. Louis S. W. Railway v. Arkansas*, 235 U. S. 350, 367-368.

The contention that there is a want of due process in the proceedings for enforcement of the tax, especially in the lien imposed by sec. 11 upon all of the delinquent's property, real and personal, reduces itself to this: that the State is without power to create a lien upon any property of a non-resident for income taxes except the very property from which the income proceeded; or, putting it in another way, that a lien for an income tax may not be imposed upon a non-resident's unproductive property, nor upon any particular productive property beyond the amount of the tax upon the income that has proceeded from it.

But the facts of the case do not raise this question. It clearly appears from the averments of the bill that the whole of plaintiff's property in the State of Oklahoma consists of oil-producing land, oil and gas mining leaseholds, and other property used in the production of oil and gas; and that, beginning at least as early as the year 1915, when the Act was passed, and continuing without interruption until the time of the commencement of the suit (April 16, 1919), he was engaged in the business of developing and operating these properties for the production of oil, his entire business in that and other States was managed as one business, and his entire net income in the State for the year 1916 was derived from that business. Laying aside the probability that from time to time there may have been changes arising from purchases, new leases, sales, and expirations (none of which, however, is set forth in the bill), it is evident that the lien will rest upon the same property interests which were the source of the income upon which the tax was imposed. The entire jurisdiction of the State over appellant's property and business and the income that he derived from them—the only jurisdiction that it has sought to assert—is a jurisdiction *in rem*; and we are clear that the State acted within its lawful power in treating his property interests and business as having both unity and continuity. Its purpose to impose income taxes was declared in its own constitution, and the precise nature of the tax and the measures to be taken for enforcing it were plainly

set forth in the Act of 1915; and plaintiff having thereafter proceeded, with notice of this law, to manage the property and conduct the business out of which proceeded the income now taxed, the State did not exceed its power or authority in treating his property interests and his business as a single entity, and enforcing payment of the tax by the imposition of a lien, to be followed by execution or other appropriate process, upon all property employed in the business.

No. 531. Appeal dismissed.

No. 580. Decree affirmed.

Mr. Justice McReynolds dissents.

Pro. ex rel. ALPHA PORTLAND CEMENT COMPANY V. KNAPP

Court of Appeals.

The People of the State of New York on the relation of
*Alpha Portland Cement Company, Respondent v. Walter H.
Knapp, and others, Appellants.* (Decided November 23, 1920.)

Appeal from an order of the Appellate Division of the Supreme Court for the third department annulling a determination of the State Tax Commission which assessed a tax against the relator under Article 9A of the Tax Law.

Charles D. Newton, Attorney General, (C. T. Dawes of Counsel),
for appellants.

Louis H. Porter for respondent.

CARDOZO, J.:

The relator, a corporation organized in New Jersey, manufactures and sells its products here and elsewhere. A tax was assessed against it in 1918 by the Tax Commission of New York for the privilege of doing business. The validity of the statute which assumes to authorize the tax, is the question to be determined.

Article 9A of the Tax Law (Consol. Laws, chap. 60), as adopted in 1917 and amended in 1918, establishes a new scheme of taxation for manufacturing and mercantile corporations, both foreign and domestic (L. 1917, c. 726; L. 1918, c. 276; L. 1918, c. 417). Every domestic manufacturing or mercantile¹ corporation is to pay an annual tax for the privilege of exercising its franchises in this state in a corporate or organized capacity (Tax Law, sec. 209). Every foreign corporation of like nature is to pay an annual tax for the privilege of doing business in this state (sec. 209). In each case the tax is to be computed upon the basis of the net income for the year next preceding, which income is declared to be "presumably the same as the income upon which such corporation is required to pay a tax to the United States" (sec. 209). If the entire business of the corporation is transacted within the state, the tax is to be based upon the entire net income as reported to the United States Treasury department, subject to correction for fraud, evasion, or error (sec. 214). If the entire business is not transacted within the state, the tax is to be based upon a proportion of net income to be ascertained by the commission in accordance with prescribed rules (sec. 214).

¹By amendments in Laws of 1919 the words "manufacturing" and "mercantile" were omitted.

The net income allocated to this state is to bear the same ratio to the entire net income as the aggregate of certain classes of assets within this state bears to the aggregate of certain classes of assets wherever situated. The real property and the tangible personal property here are to be compared with the like property here and elsewhere. The bills and accounts resulting from manufacturing, sales and services here are to be compared with the like bills and accounts here and elsewhere. The shares of stock in other corporations, if found to have a situs here, but not exceeding ten per cent. of the value of the local realty and the local tangible personalty, are to be compared with the total shares in other corporations, but not exceeding ten per cent. of all the realty and all the tangible personalty. No assets not included in the enumerated classes are to enter into the ratio. The scheme of allocation takes no heed of investments in bonds and like intangible assets. (secs. 208, 214). It takes no heed of investments in shares of other corporations, except within the prescribed limit of ten per cent. A foreign corporation, investing in railroad bonds or bonds of foreign governments, must pay a tax upon income which includes the interest on such bonds, but may not include the bonds themselves in estimating the proportion of value within the state and elsewhere. A foreign corporation which runs its business through subsidiaries, receiving the bulk of its income through dividends thus collected, must pay a tax upon income which includes the dividends on the shares, but must disregard the shares themselves (beyond the ten per cent. maximum) in the allocation of its assets. I quote for greater certainty in a foot-note the statutory formula.

The relator, engaged in both interstate and local commerce, attacks this scheme of allocation as beyond the power of the state. Included in the relator's investments and held at the home office, are bonds of the value of \$658,052.30, which yielded \$32,407 in interest during the year covered by the assessment. The interest enters into the income on which the tax has been computed; the principal has been excluded in the allocation of the assets. Included in the relator's investments are shares of stock of the Alpha Portland Cement Company of Pennsylvania of the value of \$4,500,000; shares of stock of the Anvil Stone Company of the value of \$23,600; and shares of stock of the North American Portland Cement Company of the value of \$10,000. The Alpha Portland Cement Company of Pennsylvania holds the title to plants located in that state. The relator, owning the entire stock, has occupied the plants, rent free, and has operated them directly. If it had operated them indirectly through the management of its subsidiary, and had taken the net income, which was nearly \$400,000, in the form of dividends on the shares, this scheme of allocation, if valid, would have included the dividends as income and disregarded the shares in fixing the situs of the assets. "The constitutional validity of a law is to be tested, not by what has been done under it, but by what may, by its authority, be done" (*Stuart v. Palmer*, 74 N. Y. 183, 188; *Colon v. Lisk*, 153 N. Y. 188, 194; *Coe v. Armour Fer-*

tilizer Works, 237 U. S. 413, 424). Dividends from other shares, those of the Anvil Stone Company, are included in the income; the shares themselves do not enter the terms of the proportion.

1. I think the statute is invalid, in its application to the relator, in so far as it lays upon income a burden that is irrespective of the situs of the assets by which income is produced. The power of a state to attach conditions to the transaction of intrastate business by foreign corporations, is not unlimited today, whatever under earlier decisions it may once have seemed to be. The field of law is one where new rules are in the making. Only the Supreme Court of the nation can definitively fix their content. The judgment of a state court can hardly fail, in the meantime, to be tentative and groping. We must shape our path and our progress by such light as we have. No doubt in the earlier cases there was much said, if not decided, that would seem to emancipate the state from all restrictions in conditioning the local business (*Horn Silver Mining Co. v. New York*, 143 U. S. 305; *Maine v. Grand Trunk Ry. Co.* 142 U. S. 217; *Home Ins. Co. v. N. Y.*, 134 U. S. 594; *Ashley v. Ryan*, 153 U. S. 436). Later cases have explained and qualified these judgments, and, to the extent of conflict, overruled them (*International Paper Co. v. Mass.*, 246 U. S. 135; *Looney v. Crane Co.*, 245 U. S. 178; *Western Union Telegraph Co. v. Kansas*, 216 U. S. 1; *Meyer, Auditor of Oklahoma v. Wells Fargo & Co.*, 223 U. S. 298; *Wallace v. Hines*, 252 U. S. —; 40 Sup. Ct. 435; *Powell, Indirect Encroachment on Federal Authority*, 31 Harvard Law Review, 721, 774, 932, 942; *Powell, The Changing Law of Foreign Corporations*, 33; *Political Science Quarterly* 569; *Henderson, Foreign Corporations in American Constitutional Law*, Harvard University Press, pp. 131, 134, 151, 161). The rule now is that a foreign corporation may not be required to purchase relief from ouster at the price of a surrender of constitutional immunities. The state may not say that the right to conduct the local business shall be lost if the corporation exercises the privilege of resorting to the federal courts (*Donald v. Phila. & Reading Coal Co.*, 241 U. S. 329; *Harrison v. St. Louis, etc., Ry. Co.*, 232 U. S. 318; *Henderson, Foreign Corporations in American Constitutional Law*, p. 141). The state may not say that the right to conduct the local business shall be lost if the corporation will not pay a tax upon property which, by reason of its situs elsewhere, is immune from taxation here (*Int. Paper Co. v. Mass.*; *Looney v. Crane Co.*; *W. U. T. Co. v. Kansas*; *Meyer, Auditor of Oklahoma v. Wells Fargo & Co.*; *Wallace v. Hines*, *supra*; *N. Y. Life Ins. Co. v. Head*, 234 U. S. 149, 164). This is certainly the law when the business of the corporation embraces interstate as well as local commerce. We are not now required to decide whether it is not equally the law when the business is restricted to local commerce only (*Henderson*, *supra*). *International Paper Co. v. Mass.*, *supra*, puts the modern doctrine in a sentence: "That a foreign corporation is partly, or even chiefly, engaged in interstate commerce does not prevent a state in which it has property and is doing a local business from taxing that property and im-

posing a license fee or excise in respect of that business, but the state cannot require the corporation as the condition of the right to do a local business therein to submit to a tax on its interstate business or on its property outside the state." (P. 141.) In determining whether the tax is in truth a tax on property, we are to consider, not its form or label, but its practical operation (*Int. Paper Co. v. Mass.*, supra; *Am. Mfg. Co. v. St. Louis*, 250 U. S. 459). Thus, a tax, denominated a license, is in fact a tax on property if measured by the entire capital of a manufacturing corporation irrespective of the situs (*Looney v. Crane*; *Int. Paper Co. v. Mass.*, supra). So a tax assessed against a railroad, though classified as an excise, will be invalid, like a tax on property, if values which are extra-territorial are unreasonably made the measure of values which are local (*Wallace v. Hines*, 252 U. S. —; 40 Sup. Ct. 435; cf. *Union Tank Line Co. v. Wright*, 249 U. S. 275). In one case (*Wallace v. Hines*, supra) the test of mileage was rejected when values in sparsely settled plains were thereby put upon a par with those in populous communities. In another (*Union Tank Line Co. v. Wright*, supra) the value of local cars was held to be unrelated to mileage in the state and out of it. A burden, arbitrarily swollen by resort to foreign assets, is not saved by the label which identifies it as a tax upon a local privilege.

Tested by these precedents, the tax imposed upon this franchise must be held in practical operation to be a tax upon the income. Such, indeed, it would be in form as well as in substance, if the legislature had not stated (sec. 209) that the "privilege of doing business" was the consideration for the payment. Nothing but that recital stands between the statute and conceded invalidity. How the legislature itself looked upon the substance of the burden is indicated by other provisions of the same and later statutes. The tax is to be in lieu of all other taxes on personal property or capital stock (Tax Law, sec. 219-J). It is to be in lieu of all other taxes upon income (sec. 350, subd. 7). There surely was no intention that all mercantile and manufacturing corporations, foreign and domestic, should in very truth be exempt from taxes upon property so fundamental in importance as capital and the fruits of capital. The reason for the apparent exemption was that, under the form of a tax upon the franchise, the property of such corporations had already been subjected to its share of public burdens.

I think, therefore, that in substance, though not in form, in tendency, though not in name, this tax is equivalent to a tax upon relator's income. The only question then is whether the method of allocation is reasonably adapted to the apportionment of income according to the situs of its origin. The state substantially concedes that a tax on income could not stand if allocated on such a basis. *Meyer, Auditor of Oklahoma v. Wells Fargo & Co.*, (223 U. S. 298); *Shaffer v. Carter*, (252 U. S. 37), and *Travis v. Yale & Towne Mfg. Co.* (252 U. S. 60), are sufficient in themselves to justify the concession. In the first case, the tax was measured by the entire income. The scheme of allocation limited the assessors to the com-

parison of the receipts of business done within the state with the receipts of business there and elsewhere. Investments in bonds and lands were disregarded in the apportionment, though the income from such investments was included in the measure. On that ground, as well as on others, the statute was held invalid. There is no distinction between that case and this (so far as the objection just stated is concerned) except in the label of the burden. Here, as there, the statute prescribes a rule of allocation which, as applied to foreign corporations holding bonds and shares in other states, involves an artificial and arbitrary augmentation of the value of the local privilege. It measures the value of the franchise, here and elsewhere, by income from all sources, and excludes some of the same sources when the value is apportioned. To take from assets elsewhere is equivalent to adding to assets here. The statute would be little different in principle if it announced the arbitrary rule that all investment in bonds and stocks should be conclusively presumed to have their situs in New York. The resulting vice in the proportion is not the consequence of adventitious circumstances, of inequalities developing unexpectedly in the practical workings of the statute, but hardly to be avoided by reasonable foresight. The exclusion of bonds and stocks is the result of an explicit mandate. The principle of allocation is not followed to its natural and obvious outcome in accordance with the situs of the assets, but is consciously checked, its normal course is thwarted, by an artificial and designed exception. Something which, in the absence of express exclusion, would be within its operation, is knowingly taken out of it. I am unable to avoid the conclusion that a method of apportionment which purposely ignores realities, which compels an assessor to look to some of the assets only, and close his eyes to all the others, is arbitrary and unreasonable in its increase of the local burden.

It does not help the case to argue that bonds and stock certificates can be moved from state to state, and that frauds upon the tax might become common if possession in another jurisdiction were accepted as the test. That may be a very good reason why such assets and their income should be eliminated altogether from both branches of the proportion. It is no reason why, the income being included, the assets yielding the income should be excluded for the purpose of apportionment. There is no greater difficulty, moreover, in fixing the situs of shares beyond the ten per cent limit than in fixing that of shares below it. Rejected too must be the argument that the plan of apportionment is made valid by the possibility that the excluded assets will sometimes have their situs here, in which event the taxpayer may be helped by their exclusion. That is mere chance. The state does not expect that the chances will preponderate in favor of such an outcome, or it would have used some other formula. The argument, if accepted, would sustain the tax condemned in *Meyer, Auditor of Oklahoma v. Wells Fargo & Co.*, (supra), and, indeed, would serve to justify the most obvious vagaries. The legislature in that view might exclude everything but real estate from its scheme of allocation,

and justify the restriction upon the plea that profit would result to some one. Such hit or miss methods do not take the place of regularity and system. The taxpayer complaining of the tax is injured. It does not help the statute that another may be benefited.

2. The question remains whether what is bad may be severed from what is good, and the substance of the scheme preserved. I think the severance is possible. Two defects have been found. The remedy for each will be separately considered.

(a) To remedy the first, all that has to be done is to permit the relator to subtract the interest on its bonds from the income of the year. I think this does not involve the revision in any prohibited sense of the legislative scheme. A particular item, erroneously included, is eliminated, and the tax measured by what is left. Such a situation comes closer to *Ratterman v. Western Union Tel. Co.*, (127 U. S. 411), and the cases there cited, where a tax imposed generally on the receipts of foreign and domestic commerce, was divided into its valid and invalid elements, than to *Meyer, Auditor of Oklahoma v. Wells Fargo & Co.*, (223 U. S. 298), where the invalid was so commingled with the valid, was so large and essential a part of a single scheme, that revision was adjudged impossible (223 U. S. at p. 302). Even there it was recognized that the propriety of severance was a subject upon which the state court would speak with final authority, since in last analysis it was a question of the legislative purpose (*cf. Berea College v. Kentucky*, 211 U. S. 45, 55; *Loeb v. Columbia Township Trustees*, 179 U. S. 472, 490; *Huntington v. Worthen*, 120 U. S. 97). In this state, we have gone far in subdividing statutes, and sustaining them so far as valid (*Dollar Co. v. Canadian C. & F. Co.*, 220 N. Y. 270, 278, and cases there cited; *People v. Beakes Dairy Co.*, 222 N. Y. 416, 432; *Peo. ex rel. Penn. Gas Co. v. Saxe*, 229 N. Y. 446). The tendency is, I think, a wholesome one. Severance does not depend upon the separation of the good from the bad by paragraphs or sentences in the text of the enactment (*Loeb v. Columbia Township Trustees*, *supra*). The principle of division is not a principle of form. It is a principle of function. The question is in every case whether the legislature, if partial invalidity had been foreseen, would have wished the statute to be enforced with the invalid part excised or rejected altogether. The answer must be reached pragmatically, by the exercise of good sense and sound judgment, by considering how the statutory rule will function if the knife is laid to the branch instead of at the roots.

I think that in this instance the answer is not doubtful. The tax is one on manufacturing and mercantile corporations. The great bulk of the income of such corporations in the vast majority of cases is derived, not from interest on bonds, but from the operations of the business, i. e., from manufacture and from sale (*Adams Express Co. v. Ohio State Auditor*, 165 U. S. 194, 227; 166 U. S. 185, 225). Often bonds do not figure in the assets at all. Seldom, relatively to the total, will they be

more than a minor incident. Interest on such investments might be eliminated from the income with little disarrangement of the average results. In exceptional instances, the difference might be important, but legislation looks to probabilities. A very different situation was presented in the federal income tax case, (*Pollock v. Farmers' Loan & Trust Co.*, 158 U. S. 601). There the point was that to eliminate the items unlawfully included would mean the loss of "by far the largest part of the anticipated revenue" (158 U. S. at pp. 636, 637). Even at that, the conclusion adverse to severance provoked a strong dissent (158 U. S. at pp. 683, 698; 157 U. S. at p. 586). What was the principal in that case, is the incident in this. It would be intolerable to set aside in its entirety a comprehensive scheme of taxation, framed in the main with scrupulous fidelity to constitutional limitations, whenever it appeared that some asset, commonly of minor value, some incident of a varied aggregate, had been included without right in the subject matter of assessment. Almost every business corporation has a bank account, and sometimes the account bears interest. Let us suppose that the statute made no attempt to impose a tax upon the income from bonds, but did, by virtue of its general language, include interest on deposits in banks. Is it possible that the courts would be powerless to deduct this minor item, and let the statute stand? Such a conclusion is unthinkable. The most that can fairly be asked by the taxpayer in such conditions is that the subject-matter erroneously brought within the range of words of general application, shall be cut out and withdrawn. Unless the conclusion be unavoidable, "a general revenue statute should never be declared inoperative in all its parts because a particular part relating to a distinct subject may be invalid. A different rule might be disastrous to the financial operations of the government, and produce the utmost confusion in the business of the entire country" (*Field v. Clark*, 143 U. S. 649, 697. Here the main thing that the legislature was trying to reach was the income from a *business*. The foreign corporation is to pay the tax if it does business and not otherwise. Only the domestic corporation pays for the mere exercises of its franchise in a corporate capacity. In form, the tax is one upon the value of a privilege, and income is nothing but the measure. In substance, as we have seen, it is the same as if imposed directly upon income. If we are to view it according to its substance for the purpose of determining its validity, we must view it in the same way for the purpose of determining the propriety of separating the valid from the invalid.

Thus viewing it, I cannot doubt that the exclusion of interest on intangibles will leave the essence of the scheme intact. I find it unbelievable that a legislature willing to impose a tax with those items in, would be unwilling that the tax should stand if those items were out. Undoubtedly it wished them in if it had the legal right to keep them. To say that does not mean that rather than lose them, it would throw the project to the winds. Laws are not to be sacrificed by courts on the assumption that legislation is the play of whim and fancy. A doctrinaire

emphasis on the possible rather than the probable would forbid severance at all times. No doubt it is easy, sheltering ourselves behind some implacable tenet of the separation of governmental powers, to insist upon a certainty impossible of attainment. We do small service to the state by so intransigent a pose. Our right to destroy is bounded by the limits of necessity. Our duty is to save unless in saving we pervert. When all the world can see what sensible legislators in such a contingency would wish that we should do, we are not to close our eyes as judges to what we must perceive as men. This need is all the greater in fields where the law is in a stage of transition and readjustment (Henderson, *supra*). With the line so blurred and vague between the lawful and the unlawful, the most honestly conceived and carefully developed system of assessment may involve some element of value beyond the reach of the taxing power. I will not readily impute a desire to place the revenues of the state in jeopardy by the sacrifice of the whole whenever there is failure of a part.

(b) I pass now to the shares of stock. Much that has been said about the bonds is again applicable here. Stock investments are more likely, it may be, to represent a substantial factor in the assets, at least when the business is conducted through subsidiaries. None the less there must be many corporations that do not invest in shares at all, and few, where the dividends from shares are important elements of income as compared with earnings of the business. There are, however, special considerations, applicable to shares of stock, but inapplicable to bonds, which reinforce the argument for severance, though they suggest that the remedy in this instance is by addition to the principal rather than by subtraction from the income.

Article 9A of the Tax Law was first placed upon the statute books by Laws of 1917, c. 726, and was amended by Laws of 1918, c. 276, and Laws of 1918, c. 417. As first enacted, it provided for a comparison of the average total value of the shares of other corporations held by the taxpayer within the state with the average total value of the shares in other corporations held within and without the state, the value to be apportioned in and out of the state in accordance with the value of the physical properties in and out of the state representing such share stock (sec. 214, subds. 3 and 6). The amendment of 1918 (c. 417) added a proviso that the shares within the state must not exceed ten per cent. of the real and tangible personal property within the state, and that the total shares must not exceed ten per cent. of the total real and tangible personal property (sec. 214, subds. 3 and 6). Subdivision 3 was made to read: "The proportion of the average value of the stocks of other corporations owned by the corporation allocated to the state as provided by this section, *but not exceeding ten per centum of the real and tangible personal property segregated to this state under this article,*" the part in italics being new. Subdivision 6 was made to read: "The average total value of the stocks of other corporations owned by the corporation, *but not exceeding ten per centum of the aggregate real and tangible personal property set up in*

this report," again the part in italics being new. No change other than the addition of these provisos was made in either subdivision.

In these circumstances the history of the statute defines the lines of cleavage that severance should follow. The amendment, being invalid, is to be excised, and the statute in its valid form, preserved. A scheme of allocation, lawful in its inception, but made unlawful thereafter by force of an illegitimate proviso, is not for that reason to be abandoned altogether. The amendment falls. The rule which there was an abortive effort to amend survives (*Huntington v. Worthen*, 120 U. S. 97, 102; General Construction Law, sec. 95).

I have said that the statute, in so far as it deals with shares, is valid as first enacted, when applied to this relator. I do not overlook the provision that "the value of share stock of another corporation owned by a corporation liable hereunder shall for purposes of allocation of assets be apportioned in and out of the state in accordance with the value of the physical property in and out of the state representing such share stock" (sec. 214 sub. 6). Whether this provision might sometimes, even though the limitation of ten per cent. were disregarded, work injustice to the taxpayer, we need not now determine. That problem will be solved when it arises. Something, doubtless, may be sacrificed to convenience and certainty of assessment, provided it is not too much. The proportion between values within the jurisdiction and values elsewhere can never, in any system of taxation, be maintained with mathematical precision. Departures from the form that would be illegitimate in the allocation of the assets of the corporation subject to the tax, may conceivably be legitimate in the allocation of the assets of other corporations in which it happens to be a shareholder; else, the process of appraisement and allocation might lose itself in a wilderness of refinements and complexities, the segregation of A's assets calling for the segregation of those of B, that of D's assets for that of C's, and so on through a series. I do not dwell upon this subject now, for the relator certainly could not be wronged by such a method of allocation, whether others would be aggrieved or not. All the assets of its subsidiaries are located without the state. None, therefore, could be allocated to New York under the scheme of distribution in force under the statute as first enacted. Apportionment of the shares according to the situs of the physical property of the subsidiaries in and out of the state, would safeguard the relator against the possibility of prejudice, if the proviso were eliminated. The elimination of the proviso, therefore, must be the limit of its right.

My conclusion is that the relator should be permitted to subtract from the income the item of interest on the bonds; that it should be permitted to add the value of its shares in other corporations to the value of its assets without the state; and that the order of the Appellate Division, in so far as it sets aside the whole tax, should be reversed, without costs to either party in this court, and the proceeding remitted to the

commission for the revision of the assessment in accordance with these views.

Chase and Crane, JJ., concur with Cardozo, J.; Andrews, J., concurs in result in opinion; Hiscock, Ch. J., and Collin, J., dissent and vote for affirmance on ground that statute is unconstitutional; Pound, J., reads dissenting opinion.

Ordered accordingly.

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STATE EX REL. FRANKLIN MILL COMPANY ET AL. V. LEWIS D.
COLLINS ET AL.

Supreme Court, Genesee County.

(109 Misc. 1)

Wheeler, J. The above entitled proceedings come before this court by virtue of writs of certiorari to review the action of the Board of Education of Union Free School District No. 2 of Batavia in assessing the relators upon personal property for school-tax purposes.

It is conceded the relator in each case is a manufacturing corporation within the definition of the so-called "Emerson Act," section 208, subdivision 3 of Chapter 726 of the Laws of 1917. The relators contend that by virtue of section 219-j of that act they are exempted from any assessment on any personal property after the act in question took effect.

On the other hand the respondents contend that the section referred to does not operate to withdraw the personal property of manufacturing corporations from the operation of the General Education Law, which provides a method of assessing property and collecting taxes for educational purposes. The cases presented for decision raise purely questions of law, to wit—a judicial interpretation of the force and effect of the "Emerson Act" as regards the Education Law and the power to tax manufacturing corporations on personal property for school purposes.

The "Emerson Act" materially changed the system of taxation in the State. This legislation was enacted in furtherance of a report of a committee appointed to examine and report on the general tax situation in the State. This report recommended "(1) The abolition of the present tax on personal property, (2) the withdrawal of general business corporations from the provisions of Section 182 [Addenda Page 42] of the tax law; and (3) the imposition of an income tax on individuals and general business corporations, including manufacturing corporations." Pursuant to this report a bill was drafted and passed by the Legislature which became Chapter 726 of the Laws of 1917.

This act imposes a tax of three per cent. on the net income of the corporations (Section 215) and provides that from the revenue so received the State Comptroller shall pay into the State Treasury two-thirds of the amount, and distribute and pay the balance to the treasurers of the several counties where the corporations are located (Section 219-h).

Section 219-j then provided "*After this article takes effect manufacturing and mercantile corporations shall not be assessed on any personal property.* After this article takes effect manufacturing and mercantile corporations shall not be assessed or taxed upon their capital stock as provided for in section twelve of this chapter, nor shall they be required

to pay the franchise tax imposed by section one hundred and eighty-two of this chapter."

The language of the section quoted is broad and explicit, exempting manufacturing corporations from all assessments on ~~any~~ of its personal property. The respondents however, contend that inasmuch as the Act of 1917 does not in express terms refer to or repeal any of the provisions of the Education Law, and as the Education Law constitutes a separate and distinct chapter of the Statutes of the State it could not have been the intention of the Legislature by Chapter 726 of the Laws of 1917 to in any manner modify or alter the provisions of the Education Law, and that the personal property of manufacturing and mercantile corporations is still taxable for the purpose of raising revenue for educational purposes. To a certain extent the Education Law does constitute a separate and distinct chapter, but we shall presently see that certain sections of that law must necessarily be read and construed in connection with the Tax Law of the State of which Chapter 726 of the Laws of 1917 forms a part.

Section 410 of the Education Law provides that "after a tax shall have been voted by a district meeting for a purpose arising during the current school year, the trustees shall assess it, and make out the tax list therefor and annex thereto their warrant for its collection."

Section 411 of the Law provides that "school district taxes shall be apportioned by the trustees upon real estate within the boundaries of the district which shall not be by law exempt from taxation." The second subdivision of the section provides that "The trustees shall also apportion the district taxes upon all persons residing in the district, and upon all corporations liable to taxation therein, *for the personal estate owned by them and liable for taxation.*"

Section 412 provides for the purpose of ascertaining the valuation of taxable property; the trustees shall ascertain it "so far as possible from the last assessment roll of the town," etc.

It is to be noted by the Education Law that the assessment against corporations is to be only on "*the personal estate owned by them and liable for taxation.*"

The Education Law nowhere undertakes to define what personal property of a corporation is "*liable for taxation.*" It nowhere lists the personal property to be exempt. Consequently in order to ascertain for what personal property a corporation may be assessed or taxed we necessarily must consult and read the other Statutes of the State, and particularly the general tax law of the State declaring the exemptions from taxation. It follows that the Education Law is not an entirely separate and independent statute, but one to be interpreted and construed in connection with the general Tax Law, and if by the general Tax Law certain property is legally exempted from all taxes in lieu of a percentage of income to be paid then it remains no longer taxable even for school purposes. To illustrate, real-estate mortgages are required to pay a recording tax, and when paid the holder of the mortgage is entitled to exemption from per-

sonal tax on that security for the amount represented. We think no one would contend that the trustees of a school district could claim the right to consider such mortgages property "liable for taxation" because the Act exempting them from further taxation contained no reference to the Education Law. What we say in reference to mortgages is equally true of real estate purchased by pension money.

We, therefore, are of the opinion that in order to limit the jurisdiction of school trustees to assess personal property of manufacturing corporations it was not necessary for the Legislature to make specific reference to the Education Law, but it was sufficient by appropriate language to enlarge the exemption and place the personal property of corporations in the list of property exempted.

The Act of 1917 simply limited the class of property against which school boards could assess taxes for school purposes. This the Legislature has power and authority to do. And the Act is just as effective as though it had undertaken to amend the Education Law by an added section to that Act itself. Indeed, it is manifest that the method pursued in the "Emerson Act" was the appropriate method of exempting corporate personal property, not only from general taxation, but from taxation for school purposes as well.

We find nothing ambiguous in the Act of 1917 so far as the question now under consideration is concerned. It may be that the statute works a hardship on certain school districts. As to the wisdom of the law the courts have nothing to do. The Legislature is the sole judge of those questions.

"All statutes must have a construction according to the language employed, and where no ambiguity District Courts cannot correct supposed defects." *Denton vs. Wickwire*, 54 N. Y. 226.

Where language is apt and the construction plain it cannot be departed from in deference to any supposed intent.

Matter of Village of Middletown, 82 N. Y. 196.

Matter of Simmons, 151 A. D. 444.

People vs. Long Island R. R. Co., 194 N. Y. 130.

We are of the opinion the relators are entitled to the relief asked.

So ordered. (October 31, 1919.)

Order in *Franklin Mill Company vs. Collins* affirmed, July 6, 1920.—Appellate Division of the Supreme Court, Fourth Department.

STATE EX REL. LIMITED SHOE MACHINERY CORPORATION V.
CANTOR

Supreme Court, New York County.

(112 Misc. 603)

McAvoy, J.—Article 9-a of the Tax Law, commonly known as the Emerson Act, was enacted by the Legislature in 1917 and levied a franchise tax on domestic corporations and a tax for the privilege of doing business on foreign corporations who had a situs for the place of business within this state. The basis of the tax is the net income of the corporate enterprises and reference is usually made to the tax imposed by this article as the Corporation Income Tax. Its provisions laid a tax of 3 per cent. on the taxable net income of a corporation. In 1919 the rate was increased to 4½ per cent. When this article took effect exemptions were granted to certain corporations affected thereby from personal property tax and from the tax levied by provisions of section 12, 27, 182 and 192 of the Tax Law. In 1918 section 219-j of the Tax Law, which granted the exemptions proposed under the new scheme of taxation embodied in this Corporation Income Tax Act, was amended to read: "Section 219-j. Exemptions from certain other taxation. After this article takes effect, corporations taxable thereunder shall not be assessed on any personal property or capital stock, as provided for in section 12 of this chapter. . . . " The New York City Board of Taxes and Assessments levied a tax against the personal property of the relators in October, 1919, for the taxable year of 1920, upon the theory that the exemption clause above quoted did not include any relief of foreign corporations, to which category both relators belong, from local personal tax assessments. Under the Act of 1917, section 219-j, of the Tax Law, recited the exemptions of capital stock of corporations and personal property of these entities in separate clauses. In the Act of 1918 section 219-j combined the clauses in one paragraph without any indication of an intent to change the policy upon which the exemptions theretofore granted had been allowed. The judicial history of the efforts to reach by taxation a proper contribution from both domestic and foreign corporations indicates the reason for the use of the terms "capital stock" and "personal property." These terms have significance because of the trend of the decisions of the courts which prevented any tax upon foreign corporations laid *in personam* and required a levy to go against property of the corporation here *in rem*. The capital stock of domestic corporations has been assessed for taxation for local purposes ever since 1827, and without variance down to the enactment of article 9-a, 1917, the present system of taxing domestic corporations thereon has been in vogue. This preservation of nomenclature indicates a legisla-

tive intent to provide exemption for both classes of corporate bodies, domestic and foreign. No limitation is placed upon the word "corporation" in the exemption clause, and the significance of the use of these peculiar terms will utterly fail unless they were construed to extend to the coverage in exemption of both foreign and domestic corporations. The policy lying within the enactment of article 9-a of the Tax Law of 1917 and its amendments in 1918 was to put these corporations under the provisions of a franchise tax based upon their net income in lieu of taxes on personal property, etc., and in this regard to take them entirely out of the jurisdiction of local assessors (*People ex rel. Barcalo Mfg. Co. vs. Knapp*, 187 App. Div. 89, affirmed 227 N. Y. 64 [Addenda Page 29 herein]). The contention of the City of New York that the punctuated exemption clause relates the words "personal property" to the phrase "as provided for in section 12 of this chapter" does not seem to me to be a basis for sound construction. Section 12 of the Tax Law makes no mention whatever of personal property. Foreign corporations were hitherto taxable on their personal property under section 7. Domestic corporations, as has been pointed out, were taxable upon their capital stock exclusively under section 12. The manifest lack of relativity between section 219-j and section 12 upon the subject of personal property as a basis for taxation is sufficient ground for the rejection of this theory of construction. The Legislature of 1920, by an act entitled Chapter 113 of the Laws of 1920 [Addenda Page 17 herein], enacted a provision to amend the Tax Law "in relation to correcting a manifest error in the punctuation of section 219-j thereof," etc. The sole amendment is the change of the comma from after the words "capital stock" to the position after the words "personal property," so that as punctuation goes the relation of the words "as provided for in section 12 of this chapter" is confined wholly to the term "capital stock." While this is merely persuasive of the legislative intent of the Legislature of 1919 and is not conclusive upon the courts in construction, it bears out to the full the intention of the policy as announced in 1917 of exemption of both foreign and domestic corporations from local personal taxation by local assessors when such corporations were subjected to the provisions of the so-called Corporation Income Tax Act of that year. Motions to quash the writs of certiorari are denied; the writs will be sustained and the tax levied canceled. Motion denied.

Appeal, taken on above, withdrawn November 27, 1920.

APPENDIX C

THE NEW YORK PERSONAL INCOME TAX LAW

ARTICLE XVI

As enacted by Chapter 627 of the Laws of 1919, with
all the amendments passed in 1920.

The amendments are indicated as follows:

1. Matter in *italics* is new.
2. Matter in brackets [] is the original law omitted.

- Section 350. Definitions.
351. Imposition of income tax.
- 351-a. Reimposition of tax against nonresidents.
- 351-b. Tax a debt.
352. Exemption of certain personal property.
353. Ascertainment of gain and loss.
354. Exchange of property.
355. Gain through exchange.
356. Inventory.
357. Net income defined.
358. Computation of net income.
359. Gross income defined.
360. Deductions.
361. Items not deductible.
362. Exemptions.
363. Credit for taxes in case of taxpayers other than residents of the State.
364. Partnerships.
365. Estates and trusts.
366. Information and payment at source.
367. Taxpayers' returns.
368. Partnership returns.
369. Fiduciary returns.
370. Returns when accounting period changed.
371. Time and place of filing returns.
372. Administration of income tax law.
373. Powers of comptroller.
- 373-a. Oaths and acknowledgments.

- 374. Revision and readjustment of accounts by comptroller.
troller.
- 375. Review of determination of comptroller by certiorari
and regulations as to writ.
- 376. Penalties, additional taxes and interest.
- 377. When payable.
- 378. Notice of assessment.
- 379. Collection of taxes; penalties and interest.
- 380. Warrant for the collection of taxes.
- 381. Action for recovery of taxes.
- 382. Distribution of the income tax.
- 383. Comptroller to make regulations and collect facts.
- 384. Secrecy required of officials; penalty for violation.
- 385. Contract to assume income tax illegal.

Section 350. **Definitions.**—For the purpose of this article and unless otherwise required by the context:

1. The word "comptroller" means the State comptroller.
2. The word "taxpayer" includes any person, trust or estate subject to a tax imposed by this article, or whose income is in whole or in part subject to a tax imposed by this article, and does not include corporations.
3. The words "military or naval forces of the United States" include the marine corps, the coast guard, the army nurse corps, female, and the navy nurse corps, female, but this shall not be deemed to exclude other units otherwise included within such words.
4. The words "taxable year" mean the calendar year, or the fiscal year ending during such calendar year, upon the basis of which the net income is computed under this article. The words "fiscal year" mean an accounting period of twelve months, ending on the last day of any month other than December.
5. The word "fiduciary" means a guardian, trustee, executor, administrator, receiver, conservator, or any person, whether individual or corporate, acting in any fiduciary capacity for any person, trust or estate.
6. The word "paid" for the purposes of the deductions and credits under this article, means "paid or accrued" or "paid or incurred," and the terms "paid or incurred" and "paid or accrued" shall be construed according to the method of accounting upon the basis of which the net income is computed, under this article. The term "received" for the purpose of the computation of net income under this article, means "received or accrued" and the term "received or accrued" shall be construed according to the method of accounting upon the basis of which the net income is computed under this article.
7. The word "resident" applies only to natural persons and includes for the purpose of determining liability to the tax imposed by

this article upon or with reference to the income of any taxable year, commencing with the year nineteen hundred and nineteen, any person who shall, at any time *during the last six months of the* [on or after January first and not later than March fifteenth of the next succeeding] calendar year, be [or become] a resident of the state. (*Amended by chap. 691, Laws 1920; effective May 10, 1920.*)

8. The word "dividend" means any distribution made by a corporation out of its earnings or profits to its shareholders or members, whether in cash or in other property or in stock of the corporation.

9. The words "foreign country" or "foreign government" mean any jurisdiction other than one embraced within the United States. The words "United States" include the States, the Territories of Alaska and Hawaii, and the District of Columbia.

10. The words "withholding agent" include all individuals, corporations, associations and partnerships, in whatever capacity acting, including lessees, or mortgagors of real or personal property, fiduciaries, employers, and all officers and employees of the State, or of any municipal corporation or political subdivision of the State, having control, receipt, custody, disposal or payment, of interest, rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments or other fixed or determinable annual or periodical gains, profits and income taxable under this article.

§ 351. **Imposition of income tax.**—A tax is hereby imposed upon every resident of the State, which tax shall be levied, collected, and paid annually upon and with respect to his entire net income as herein defined at rates as follows: One per centum of the amount of net income not exceeding ten thousand dollars; two per centum of the amount of net income in excess of ten thousand dollars, but not in excess of fifty thousand dollars; three per centum of the amount of net income in excess of fifty thousand dollars. A like tax is hereby imposed and shall be levied, collected and paid annually at the rates specified in this section, upon and with respect to the entire net income as herein defined, except as hereinafter provided, from all property owned and from every business, trade, profession or occupation carried on in this State by natural persons not residents of the State. Such tax shall first be levied, collected and paid in the year 1920 upon and with respect to the taxable income for the calendar year 1919, or for any taxable year ending during the year 1919.

§ 351-a. **Reimposition of tax against nonresidents.**—*The tax provided for in section three hundred and fifty-one of this chapter upon and with respect to income derived from all property owned and from every business, trade, profession or occupation carried on in this state by natural persons not residents of the state, is hereby reimposed with respect to the taxable income for the calendar year nineteen hundred and nineteen and for any taxable year ending during the year nineteen hundred and nine-*

teen, and for each year thereafter. Such tax shall be levied, collected and paid for the year nineteen hundred and nineteen, and returns with respect thereto shall be filed on or before June thirtieth, nineteen hundred and twenty, unless the time shall be extended as provided in this article. (Added by chap. 191, Laws 1920; effective April 14, 1920.)

§ 351-b. **Tax a debt.**—Every tax imposed by this article, and all increases, interest and penalties thereon, in addition to being a tax against property, business, trade, profession or occupation, as in this article provided, shall also become, from the time it is due and payable, a personal debt, from the person or persons liable to pay the same, to the state of New York. (Added by chap. 191, Laws 1920.)

§ 352. **Exemption of certain personal property from taxation.**—The taxes imposed by this article are in addition to all other taxes imposed by law, except that money on hand[,] or on deposit with or without [or at] interest, bonds, notes and choses in action and shares of stock in corporations other than banks and banking associations, owned by any individual or constituting a part of a trust or estate subject to the income tax imposed by this article, [and from which any income is derived,] shall not after July thirty-first, nineteen hundred and nineteen, be included in the valuation of the personal property included in the assessment-rolls of the several tax districts, villages, school districts and special tax districts of the state. (Amended by chap. 120, Laws 1920; effective June 30, 1920.)

§ 353. **Ascertainment of gain and loss.**—For the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, the basis shall be first, in case of property acquired before January 1st, 1919, the fair market price or value of such property, as of January 1st, 1919, and, second, in case of property acquired on or after that date, the cost thereof; or the inventory value, the inventory is made in accordance with this article.

§ 354. **Exchange of property.**—When property is exchanged for other property, the property received in exchange shall, for the purpose of determining gain or loss, be treated as the equivalent of cash to the amount of its fair market value, if any; but when in connection with the reorganization, merger or consolidation of a corporation, a taxpayer receives, in place of stock or securities owned by him, new stock or securities of no greater aggregate par or face value, no gain or loss shall be deemed to occur from the exchange, and the new stock or securities received shall be treated as taking the place of the stock, securities or property exchanged.

§ 355. **Gain through exchange.**—When in the case of any such reorganization, merger or consolidation the aggregate par or face

value of the new stock or securities received is in excess of the aggregate par or face value of the stock or securities exchanged, a like amount in par or face value of the new stock or securities received shall be treated as taking the place of the stock or securities exchanged, and the amount of the excess in par or face value shall be treated as a gain to the extent that the fair market value of the new stock or securities is greater than the cost of the stock or securities exchanged, if acquired on or after January 1st, 1919, and its fair market price or value as of January 1st, 1919, if acquired before that date.

§ 356. **Inventory.**—Whenever in the opinion of the comptroller the use of inventories is necessary in order clearly to determine the income of any taxpayer, inventories shall be taken by such taxpayer upon such basis as the comptroller may prescribe, conforming as nearly as may be to the best accounting practice in the trade or business and most clearly reflecting the income, and conforming so far as may be to the forms and methods prescribed by the United States commissioner of internal revenue under the act of congress known as the Revenue Act of 1918.

§ 357. **Net income defined.**—The term “net income” means the gross income of a taxpayer less the deductions allowed by this article.

§ 358. **Computation of net income.**—1. The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made upon such basis and in such manner as in the opinion of the comptroller does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year as defined in this article, or if the taxpayer has no annual accounting period or does not keep books, the net income shall be computed on the basis of the calendar year.

2. If a taxpayer changes his accounting period from fiscal year to calendar year, from calendar year to fiscal year, or from one fiscal year to another, the net income shall, with the approval of the comptroller, be computed on the basis of such new accounting period, subject to the provisions of Section 370.

§ 359. **Gross income defined.**—The term “gross income”:

1. Includes gains, profits and income derived from salaries, wages or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any

business carried on for gain or profit, or gains or profits and income derived from any source whatever, *including gains or profits or income derived through estates or trusts by the beneficiaries thereof, whether as distributed or distributable shares.* The amount of all such items shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under the methods of accounting permitted in this article, any such amounts are to be properly accounted for as of a different period; but (*Amended by chap. 695, Laws 1920; effective May 10, 1920.*)

2. Does not include the following items, which shall be exempt from taxation under this article:

a. The proceeds of life insurance policies and contracts paid upon the death of the insured to individual beneficiaries or to the estate of the insured.

b. The amount received by the insured as a return of premium or premiums paid by him under life insurance, endowment, or annuity contracts, either during the term or at the maturity of the term mentioned in the contract or upon surrender of the contract.

c. The value of property acquired by gift, bequest, devise or descent (but the income from such property shall be included in gross income.)

d. Interest upon the obligations of the United States or its possessions; or securities issued under the provisions of the Federal Farm Loan Act of July 17th, 1916; or bonds issued by the war finance corporation; or the obligations of the State of New York or of any municipal corporation or political subdivision thereof; or investments upon which the tax provided for in Section 331 of this chapter has heretofore been paid since June 1st, 1917, during the period of years for which such tax shall have been paid.

e. Any amount received through accident or health insurance or under workmen's compensation acts, as compensation for personal injuries or sickness, plus the amount of any damages received whether by suit or agreement on account of such injuries or sickness, or through the war risk insurance act or any law for the benefit or relief of injured or disabled members of the military or naval forces of the United States.

f. Salaries, wages and other compensation received from the United States of officials or employees thereof, including persons in the military or naval forces of the United States.

g. Income received by any officer of a religious denomination or by any institution, or trust, for moral or mental improvement, religious, bible, tract, charitable, benevolent, fraternal, missionary, hospital, infirmary, educational, scientific, literary, library, patriotic, historical or cemetery purposes, or for the enforcement of laws relating to children or animals, or for two or more of such purposes, if such income be used exclusively for carrying out one or more of such purposes; but

nothing herein shall be construed to exempt the fees, stipends, personal earnings or other private income of such officer or trustee.

3. In the case of taxpayers other than residents, gross income includes only the gross income from sources within the State, but shall not include annuities, interest on bank deposits, interest on bonds, notes or other interest-bearing obligations or dividends from corporations, except to the extent to which the same shall be a part of income from any business, trade, profession or occupation carried on in this State subject to taxation under this article.

§ 360. **Deductions.**—In computing net income there shall be allowed as deductions:

1. All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensations for personal services actually rendered, and including rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

2. [In the case of a resident of the state such a proportion of the total] All interest paid or accrued during the taxable year on indebtedness [as the net income of the taxpayer taxable under this article bears to his total income from all sources; or in case of an individual not a resident of the state, the same proportion of interest paid or accrued within the taxable year on indebtedness which the amount of such gross income, as herein defined, bears to the gross amount of his income from all sources within and without the state.] (*Amended by chap. 693, Laws 1920; retroactive to January 1, 1920.*)

3. Taxes other than income taxes paid or accrued within the taxable year imposed, first, by the authority of the United States, or of any of its possessions, or, second, by the authority of any State, or Territory, or any county, school district, municipality, or other taxing subdivision of any State or Territory, not including those assessed against local benefits of a kind tending to increase the value of the property assessed, or, third, by the authority of any foreign government.

4. Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in trade or business.

5. Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit, though not connected with the trade or business; but in the case of a taxpayer other than a resident of the state, only as to such transactions in real property or in tangible personal property having an actual situs within the state. (*Amended by chap. 693, Laws 1920; retroactive to January 1, 1920.*)

6. Losses sustained during the taxable year of property not connected with the trade or business (but, in the case of a taxpayer other

then a resident, only of *real property or tangible personal property having an actual situs* within the state) if arising from fires, storms, shipwrecks, or other casualty or from theft, and not compensated for by insurance or otherwise. (*Amended by chap. 693, Laws 1920; retroactive to January 1, 1920.*)

7. Debts ascertained to be worthless and charged off within the taxable year.

8. A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence.

9. In the case of mines, oil and gas wells, other natural deposits and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case, based upon cost including cost of development not otherwise deducted; provided, that in the case of such properties acquired prior to January 1st, 1919, the fair market value of the property (or the taxpayer's interest therein) on that date shall be taken in lieu of cost up to that date; provided, further, that in the case of mines, oil and gas wells, discovered by the taxpayer on or after January 1st, 1919, and not acquired as the result of a purchase of a proven tract or lease, where the fair market value of the property is materially disproportionate to the cost, the depletion allowance shall be based upon the fair market value of the property at the date of the discovery or within thirty days thereafter; such reasonable allowance in all the above cases to be made under rules and regulations to be prescribed by the comptroller. In the case of leases, the deductions allowed by this paragraph shall be equitably apportioned between the lessor and lessee.

10. Contributions or gifts made within the taxable year to corporations [incorporated by,] or associations [organized under, the laws of this state and] operated exclusively for religious, charitable, scientific or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private stockholder or individual, or to the special fund for vocational rehabilitation authorized by section seven of the act of congress known as the vocational rehabilitation act, to an amount not in excess of fifteen per centum of the taxpayer's net income as computed without the benefit of this subdivision. Such contributions or gifts shall be allowable as deductions only if verified under rules and regulations prescribed by the comptroller. In the case of a taxpayer other than a resident of the state this deduction shall be allowed only as to contributions or gifts made to corporations or associations incorporated by or organized under the laws of this state or to the vocational rehabilitation fund above mentioned. (*Amended by chap. 693, Laws 1920; retroactive to January 1, 1920.*)

11. In the case of a taxpayer other than a resident of the State, the deductions allowed in this section shall be allowed only if, and to the extent that, they are connected with income arising from sources within the State; and the proper apportionment and allocation of the deductions with respect to sources of income within and without the State shall be determined under rules and regulations to be prescribed by the comptroller.

§ 361. **Items not deductible.**—In computing net income no deduction shall in any case be allowed in respect of:

1. Personal, living, or family expenses;
2. Any amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate;
3. Any amount expended in restoring property or in making good the exhaustion thereof for which an allowance is or has been made; or
4. Premiums paid on any life insurance policy, covering the life of any officer or employee, or of any person financially interested in any trade or business carried on by the taxpayer, when the taxpayer is directly or indirectly a beneficiary under such policy.

§ 362. **Exemptions.**—The following exemptions shall be allowed to any [resident] taxpayer:

1. In the case of a single person, a personal exemption of one thousand dollars, or in the case of the head of a family or a married person living with husband or wife, a personal exemption of two thousand dollars. A husband and wife living together shall receive but one personal exemption of two thousand dollars against their aggregate net income; and in case they make separate returns, the personal exemption of two thousand dollars [may be taken by either or] *shall be equally divided between them.*

2. Two hundred dollars for each person (other than husband or wife) dependent upon and receiving his chief support from the taxpayer, if such dependent person is under eighteen years of age or is incapable of self-support because mentally or physically defective. (*Amended by chap. 191, Laws 1920; effective April 14, 1920.*)

NOTE. Subdivision 3, limiting exemption to taxpayer receiving compensation from United States, was repealed by chap. 58, Laws 1920, effective as to 1919 returns.

§ 363. **Credit for taxes in case of taxpayers other than residents of the State.**—Whenever a taxpayer other than a resident of the state has become liable to income tax to the state or country where he resides upon his net income for the taxable year, derived from sources within this state and subject to taxation under this article, the comptroller shall credit the amount of income tax payable by him under this article with such proportion of the tax so payable by him to the state

or country where he resides as his income subject to taxation under this article bears to his entire income upon which the tax so payable to such other state or country was imposed; provided that such credit shall be allowed only if the laws of said state or country (1) grant a substantially similar credit to residents of this state subject to income tax under such laws or (2) *impose a tax upon the personal incomes of its residents derived from sources in this state and exempt from taxation the personal incomes of residents of this state. No credit shall be allowed against the amount of the tax on any income taxable under this article which is exempt from taxation under the laws of such other state or country. This section as amended shall apply to taxes for the year nineteen hundred and nineteen and each year thereafter. (Amended by chap. 691, Laws 1920; effective May 10, 1920.)*

§ 364. **Partnerships.**—Individuals carrying on business in partnerships shall be liable for income tax only in their individual capacity. There shall be included in computing the net income of each partner his distributive share, whether distributed or not, of the net income of the partnership for the taxable year, or, if his net income for such taxable year is computed upon the basis of a period different from that upon the basis of which the net income of the partnership is computed, then his distributive share of the net income of the partnership for any accounting period of the partnership ending within the fiscal or calendar year upon the basis of which the partner's net income is computed. Taxpayers who are members of partnerships may be required by the comptroller to make a return stating the gross receipts and net gains or profits of the partnership for any taxable year. The net income of the partnership shall be computed in the same manner and on the same basis as provided in computing the net income of individuals except that the deduction provided in Subdivision 10 of Section 360 shall not be allowed and the personal exemptions provided for in Section 362 shall be allowed only to the individual partners.

§ 365. **Estates and trusts.**—1. The tax imposed by this article shall apply to *estates and trusts, which tax shall be levied, collected and paid annually upon and with respect to the income of estates or of any kind of property held in trust, including:*

a. Income received by estates of deceased persons during the period of administration or settlement of the estate;

b. Income accumulated in trust for the benefit of unborn or unascertained person or persons with contingent interests;

c. Income held for future distribution under the terms of the will or trust; [and]

d. Income which is to be distributed to the beneficiaries periodically, whether or not at regular intervals, and the income collected

by a guardian of an infant to be held or distributed as the court may direct[.]; and

e. Income of an estate during the period of administration or settlement permitted by subdivision three to be deducted from the net income upon which the tax is to be paid by the fiduciary.

2. The fiduciary shall be responsible for making the return of income for the estate or trust for which he acts, *whether such income be taxable to the estate or trust or to the beneficiaries thereof*. The net income of [the] *an* estate or trust shall be computed in the same manner and on the same basis as provided in this article for individual taxpayers, except that there shall also be allowed as a deduction any part of the gross income which pursuant to the terms of the will or deed creating the trust, is during the taxable year paid to or permanently set aside for the United States, any state, territory, or any political subdivision thereof, or the District of Columbia, or any corporation or association organized and operated exclusively for religious, charitable, scientific or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private stockholder or individual; and in cases under paragraphs *d* and *e* of subdivision one of this section, the fiduciary shall include in the return a statement of each beneficiary's distributive share of such net income, whether or not distributed before the close of the taxable year for which the return is made.

3. In cases under paragraphs *a*, *b*, and *c* of subdivision one, of this section, the tax shall be imposed upon *the estate or trust with respect to* the net income of the estate or trust and shall be paid by the fiduciary, except that in determining the net income of the estate of any deceased person during the period of administration or settlement there may be deducted the amount of any income properly paid or credited to any legatee, heir or other beneficiary. In such cases, the estate or trust shall be allowed the same exemptions as are allowed to single persons under section three hundred and sixty-two, and in such cases an estate or trust created by a person not a resident and an estate of a person not a resident shall be subject to tax only to the extent to which individuals other than residents are liable under section three hundred and fifty-nine, subdivision three.

4. In cases under paragraphs *d* and *e* of subdivision one of this section [and in the case of any income of an estate during the period of administration or settlement permitted by subdivision three to be deducted from the net income upon which tax is to be paid by the fiduciary], the tax shall not be paid by the fiduciary, but there shall be included in computing the net income of each beneficiary his distributive share whether distributed or not, of the net income of the estate or trust for the taxable year, or, if his net income for such taxable year is computed upon the basis of a period different from that upon the basis of which the net income of the estate or trust is computed, then his distributive share of the net income of the estate

or trust for any accounting period of such estate or trust ending within the fiscal or calendar year upon the basis of which such beneficiary's net income is computed. In such cases the income of a beneficiary [of such estate or trust] not a resident, *derived through such estate or trust*, shall be taxable only to the extent provided in section three hundred and fifty-nine, subdivision three, for individuals other than residents. (*Amended by chap. 695, Laws 1920; effective May 10, 1920.*)

§ 366. 1. *For the calendar year nineteen hundred and twenty and for each calendar year thereafter, [E] every withholding agent shall deduct and withhold [two per centum] from all salaries, wages, commissions, gratuities, emoluments, perquisites and other fixed [and] or determinable annual or periodical compensation of whatever kind and in whatever form paid or received, earned by any taxpayer for personal services and taxable under this article, of which he shall have control, receipt, custody, disposal or payment, [if the amount paid or received or to be paid or received in any taxable year on account of any individual equals or exceeds one thousand dollars, unless there shall be filed with the withholding agent, before the time when he is required to make return and payment thereof, a certificate in such form as shall be prescribed by the comptroller to the effect that the person entitled to such salary, wage, commission, gratuity, emolument, perquisite or other compensation is a resident and setting forth his residence address within the state] the following amounts: one per centum of the first ten thousand dollars or less, two per centum of the next forty thousand dollars or less, and three per centum of the excess over fifty thousand dollars, by which the amount of such compensation paid or to be paid in the calendar year, by such withholding agent to such taxpayer, exceeds the amount of the exemptions granted to such taxpayer under section three hundred and sixty-two of this chapter as shown by a certificate filed with the withholding agent in form to be prescribed by the comptroller or one thousand dollars if no certificate showing his personal exemption status is filed with the withholding agent by a taxpayer other than a resident of this state. If it appears that another state has passed a law taxing incomes in such manner as will result in its residents being entitled to credit under section three hundred and sixty-three hereof, sufficient to offset all taxes imposed by this article, the comptroller may, by regulation, relieve residents of such state from being required to make any return under this article, and may prescribe a form of certificate to be filed by residents of such state with withholding agents. A withholding agent with whom such a certificate shall be filed, or with whom a certificate, in such form as shall be prescribed by the comptroller, to the effect that the person entitled to such compensation is a resident of this state and setting forth his residence address, shall be filed after the beginning of the calendar year and before the time when he is required to make return and payment, need not deduct or withhold anything from the compensation of the person*

filing such certificate. The comptroller may, by regulation, require withholding agents to forward to him at stated times any of the certificates mentioned in this subdivision. (Amended by chap. 691, Laws 1920; effective May 10, 1920.)

2. Every withholding agent shall make return to the comptroller of complete information concerning the amount of all interest, rent, salaries, wages, premiums,, annuities, compensations, remunerations, emoluments or other fixed or determinable gains, profits and income, except interest coupons payable to bearer, of any taxpayer taxable under this article of one thousand dollars or more in any taxable year under such regulations and in such form and manner and to such extent as may be prescribed by the comptroller. (*Re-enacted by chap. 691, Laws 1920; effective May 10, 1920.*)

3. Every withholding agent required to deduct and withhold any tax under Subdivision 1 of this section shall make return thereof on or before the fifteenth day of March in each year and shall at the same time pay the tax to the comptroller. Every such individual corporation or partnership is hereby made liable for such tax and is hereby indemnified against the claims and demands of any individual, corporation or partnership for the amount of any payments made in accordance with the provisions of this section.

4. Income upon which any tax is required to be withheld at the source under this section shall be included in the return of the recipient of such income, but any amount of tax so withheld shall be credited against the amount of income tax as computed in such return.

5. If any tax required under this section to be deducted and withheld is paid by the recipient of the income, it shall not be re-collected from the withholding agent; nor in cases in which the tax is so paid shall any penalty be imposed upon or collected from the recipient of the income or the withholding agent for failure to return or pay the same, unless such failure was fraudulent and for the purpose of evading payment.

§ 367. **Taxpayers' returns.**—Every taxpayer having a net income for the taxable year of one thousand dollars or over if single or if married and not living with husband or wife, or of two thousand dollars or over if married and living with husband or wife, shall make under oath a return stating specifically the items of his gross income and the deductions and credits allowed by this article. If a husband and wife living together have an aggregate net income of two thousand dollars or over, each shall make such a return unless the income of each is included in a single joint return. If the taxpayer is unable to make his own return the return should be made by a duly authorized agent or by the guardian or other person charged with the care of the person or property of such taxpayer. A taxpayer other than a resident shall not be entitled to the deductions authorized by Section

360 unless he shall make under oath a complete return of his gross income both within and without the State.

§ 368. **Partnership returns.**—Every partnership shall make a return for each taxable year, stating specifically the items of its gross income and the deductions allowed by this article, and shall include in the return the names and addresses of the individuals who would be entitled to share in the net income if distributed and the amount of the distributive share of each individual. The return shall be sworn to by any one of the partners.

§ 369. **Fiduciary returns.**—Every fiduciary (except receivers appointed by authority of law in possession of part only of the property of a taxpayer) shall make under oath a return for the [taxpayer] *individual or estate or trust* for whom he acts, as follows:

[first] 1. *If he acts for an individual whose entire income from whatever source derived is in his charge and [if] the net income of such [taxpayer] individual is one thousand dollars or over if single, or if married and not living with husband or wife, or two thousand dollars or over if married and living with husband or wife [, or second,].*

2. *If he acts (a) for an estate of a deceased person during the period of administration or settlement, whether or not the income of such estate during such period of administration or settlement is properly paid or credited to any legatee, heir or other beneficiary; (b) for an estate or trust the income of which is accumulated in trust for the benefit of unborn or unascertained persons, or persons with contingent interests; or (c) for an estate or trust the income of which is held for future distribution under the terms of the will or trust; [if] and the net income of such [taxpayer, if an] estate or trust [,] is one thousand dollars or over.*

3. *[or if any beneficiary is a taxpayer other than a resident of the state,] If he acts (a) for an estate or trust the income of which is to be distributed to the beneficiaries periodically; or (b) as the guardian of an infant whose income is to be held or distributed as the court may direct; and any beneficiary of such estate or trust receives or is entitled to a distributive share of the income of the estate or trust of one thousand dollars or more. [which return] The return made by a fiduciary shall state specially the items of the gross income and the deductions, exemptions and credits allowed by this article. Under such regulations as the comptroller may prescribe, a return made by one or two or more joint fiduciaries [and filed in the office of the comptroller or collector in the district where such fiduciary resides] shall be a sufficient compliance with the above requirement. The fiduciary shall make oath that he has sufficient knowledge of the affairs of [such] the individual, estate or trust for whom or which he acts to enable him to make the return, and that the same is, to the best of his knowledge and belief, true and correct.*

Fiduciaries required to make returns under this article shall be subject to all the provisions of this article which apply to taxpayers. (*Amended by chap. 695, Laws 1920; effective May 10, 1920.*)

§ 370. **Returns when accounting period changed.**—If a taxpayer, with the approval of the comptroller, changes the basis of computing net income from fiscal year to calendar year, a separate return shall be made for the period between the close of the last fiscal year for which return was made and the following December thirty-first. If the change is made from calendar year to fiscal year, a separate return shall be made for the period between the close of the last calendar year for which return was made and the date designated as the close of the [last] fiscal year. If the change is made from one fiscal year to another fiscal year, a separate return shall be made for the period between the close of the former fiscal year and the date designated as the close of the new fiscal year. If a taxpayer making his first return for income tax keeps his accounts on the basis of a fiscal year, he shall make a separate return for the period between the beginning of a calendar year in which such fiscal year ends and the end of such fiscal year.

In all of the above cases the net income shall be computed on the basis of such period for which separate return is made, and the tax shall be paid thereon at the rate for the calendar year in which such period is included; and the exemptions allowed in this article shall be reduced respectively to amounts which bear the same ratio to the full exemptions provided for as the number of months in such period bears to twelve months. (*Amended by chap. 691, Laws 1920; effective May 10, 1920.*)

§ 371. **Time and place of filing returns.**—Returns shall be made to the comptroller on or before the fifteenth day of the fourth month following the close of the fiscal year, or, if the return is made on the basis of the calendar year, then the return shall be made on or before the fifteenth day of [March] April in each year [of the taxpayer's net income for his last preceding taxable year]. The comptroller may grant a reasonable extension of time for filing returns whenever in [its] his judgment good cause exists and shall keep a record of every such extension and the reason therefor. Except in the case of taxpayers who are abroad, no such extension shall be granted for more than six months. Such returns shall, so far as may be, set forth the same or similar items called for in the blank forms of return prescribed by the United States commissioner of internal revenue for the enforcement of the act of congress known as the revenue act of nineteen hundred and eighteen, together with such other facts as the comptroller may deem necessary for the proper enforcement of this article. There shall be annexed to such return the affidavit or affirmation of the person making the return, to the effect that the statements contained therein are

true. Blank forms of return shall be furnished by the comptroller upon application, but failure to secure the form shall not relieve any taxpayer from the obligation of making any return herein required. (*Amended by chap. 691, Laws 1920; effective June 1, 1920.*)

§ 372. **Administration of income tax law.**—The comptroller shall administer and enforce the tax herein imposed for which purpose he may divide the State into districts in each of which a branch office of the comptroller may be maintained; provided that in no cases shall a county be divided in forming a district.

§ 373. **Powers of comptroller.**—1. If in the opinion of the comptroller, any return of a taxpayer is in any essential respect incorrect, he shall have power to revise such return, or if any taxpayer fails to make return as herein required, the comptroller is authorized to make an estimate of the taxable income of such taxpayer from any information in his possession, and to audit and state an account according to such revised returns or the estimate so made by him for the taxes, penalties and interest due the state from such taxpayer. *Except in the case of a wilfully false or a fraudulent return with intent to evade the tax, the amount of tax due under any return shall be determined by the comptroller within three years after the return was due or was made. In the case of such wilfully false or fraudulent returns the amount of tax due may be determined at any time after the return is filed and the tax may be collected at any time after it becomes due.*

2. The comptroller, for the purpose of ascertaining the correctness of any return or for the purpose of making an estimate of taxable income of any person where information has been obtained, shall also have power to examine or to cause to have examined, by any agent or representative designated by him for that purpose, [in case of failure to report the books and records of any such taxpayer] any books, papers, records or memoranda bearing upon the matters required to be included in the return, and may require the attendance of the person rendering the return or any officer or employee of such person, or the attendance of any other person having knowledge in the premises, and may take testimony and require proof material for his information, with power to administer oaths to such person or persons. (*Amended by chap. 690, Laws 1920; effective May 10, 1920.*)

§ 373-a. **Oaths and acknowledgments.**—The director of the income tax bureau, and each assistant, deputy and district director, and each cashier, senior auditor, auditor and junior auditor of the income tax bureau, shall have the power to administer an oath to any person, or to take the acknowledgment of any person in respect of any income tax report or return required by or pursuant to this article, or the rules and regulations of the comptroller. (*Added by chap. 691, Laws 1920; effective May 10, 1920.*)

§ 374. **Revision and readjustment of accounts by comptroller.**—If an application for revision be filed with the comptroller by a taxpayer

within one year from the time of the filing of the return, or if the tax of such taxpayer shall have been recomputed, then from the time of such recomputation, the comptroller shall grant a hearing thereon and if it shall be made to appear, upon any such hearing by evidence submitted to him or otherwise, that any such computation includes taxes or other charges which could not have been lawfully demanded, or that payment has been illegally made or exacted of any such amount so computed, the comptroller shall resettle the same according to law and the facts, and adjust the computation of taxes accordingly, and shall send notice of his determination thereon to the taxpayer.

§ 375. Review of determination of comptroller by certiorari and regulations as to writ.—The determination of the comptroller upon any application made to him by any taxpayer for revision and resettlement of any computation of tax, as prescribed by this article, may be reviewed in the manner prescribed by and subject to the provisions of Section 199 of this chapter. No certiorari to review any statement of a computation or any determination by the comptroller under this article shall be granted unless notice of application therefor is made within thirty days after the service of the notice of such determination. Eight days' notice shall be given to the comptroller of the application for such writ. Before making the application an undertaking must be filed with him, in such amount and with such sureties as a justice of the supreme court shall approve, to the effect that if such writ is dismissed or the determination of the comptroller affirmed, the applicant for the writ will pay all costs and charges which may accrue against him in the prosecution of the writ, including costs of all appeals.

§ 376. Penalties, additional taxes and interest.—1. *If any taxpayer without intent to evade any tax imposed by this article, shall fail to make a return of income or pay any tax if one is due at the time required by or under the provisions of this article, but shall voluntarily make a correct return of income and pay the tax due within sixty days thereafter, there shall be added to the tax an additional amount equal to five per centum thereof, but such additional amount shall in no case be less than two dollars, and an additional one per centum for each month or fraction of a month during which the tax remains unpaid. If any withholding agent, without intent to evade any tax imposed by this article, shall fail to make a return and pay a tax withheld by him at the time required by or under the provisions of this article, but shall voluntarily make a correct return and pay the tax due within sixty days thereafter, the withholding agent shall pay, and may not charge to the taxpayer, an additional amount equal to five per centum thereof, but such additional amount shall in no case be less than two dollars, and an additional one per centum for each month or fraction of a month during which the tax remains unpaid.*

2. *If any taxpayer fails voluntarily to make a return of income or to pay a tax if one is due within sixty days of the time required by or under*

the provisions of this article, the tax shall be doubled and such doubled tax shall be increased by one per centum for each month or fraction of a month from the time the tax was originally due to the date of payment.

3. *Any individual, corporation or partnership, who, without fraudulent intent, shall fail to pay, or to deduct or withhold and pay any tax, or to make, render, sign or verify any return, or to supply any information, within the time required by or under the provisions of this article, shall be liable to a penalty of not more than one thousand dollars, to be recovered by the attorney-general in the name of the people by action in any court of competent jurisdiction.*

4. *Any individual, corporation or partnership, or any officer or employee of any corporation, or member or employee of any partnership, who, with intent to evade any tax or any requirement of this article or any lawful requirement of the comptroller thereunder, shall fail to pay the tax, or to make, render, sign or verify any return, or to supply any information, within the time required by or under the provisions of this article, or who, with like intent, shall make, render, sign or verify any false or fraudulent return or statement, or shall supply any false or fraudulent information, shall be liable to a penalty of not more than one thousand dollars, to be recovered by the attorney-general, in the name of the people, by action in any court of competent jurisdiction, and shall also be guilty of a misdemeanor and shall, upon conviction, be fined not to exceed one thousand dollars or be imprisoned not to exceed one year, or both, at the discretion of the court.*

5. *The attorney-general shall have the power, with the consent of the comptroller, to compromise any penalty for which he is authorized to bring action under subdivisions three and four of this section. The penalties provided by subdivisions three and four of this section shall be additional to all other penalties in this article provided.*

6. *The failure to do any act required by or under the provisions of this articles shall be deemed an act committed in part at the office of the comptroller in Albany. The certificate of the comptroller to the effect that a tax has not been paid, that a return has not been filed, or that information has not been supplied, as required by or under the provisions of this article, shall be prima facie evidence that such tax has not been paid, that such return has not been filed, or that such information has not been supplied. (Amended by chap. 692, Laws 1920; effective May 10, 1920.)*

§ 377. **When payable.**—1. Each taxpayer shall, or in cases where an agent or a guardian or other fiduciary makes return for the taxpayer on whose behalf he is acting, then the agent, guardian or other fiduciary shall at the time of filing his return, pay to the comptroller the amount of tax payable hereunder as the same shall appear from the face of the return. If the time for filing the return shall be extended, he shall pay in addition interest thereon at the rate of six per centum per annum from the time when the return was originally required to be filed to the time of payment. *If the time for filing a return by a withholding agent*

shall be extended, the withholding agent shall pay, and may not charge to the taxpayer, interest at the rate of six per centum per annum from the time when the return was originally required to be filed to the time of payment.

2. As soon as practicable after the return is filed, the comptroller shall examine it and compute the tax.

3. If the amount of tax as computed shall be greater than the amount theretofore paid, the excess shall be paid by the taxpayer to the comptroller within [thirty] *ten* days after the amount of the tax as computed shall be mailed by the comptroller. *In such case, if the return is made in good faith and the understatement of the amount in the return is not due to any fault of the taxpayer, there shall be no penalty or additional tax because of such understatement, but interest shall be added to the amount of the deficiency at the rate of one per centum for each month or fraction of a month. If the understatement is due to negligence on the part of the taxpayer but without intent to defraud, there shall be added to the amount of the deficiency five per centum thereof, and in addition, interest at the rate of one per centum per month for each month or fraction of a month. If the understatement is false or fraudulent with intent to evade the tax, the tax on the additional income discovered to be taxable shall be doubled and an additional one per centum shall be added to the amount so due for each month or fraction of a month. The interest provided for in this subdivision shall in all cases be computed from the date the tax was originally due to the date of payment.*

4. If the amount of tax as computed shall be less than the amount theretofore paid, the excess shall be refunded by the comptroller out of the proceeds of the tax retained by him as provided in this article. (*Amended by chap. 692, Laws 1920, effective May 10, 1920.*)

§ 378. **Notice of assessment.**—(*Repealed by chap. 691, Laws 1920.*)

§ 379. **Collection of taxes; penalties and interest.**—1. The comptroller is authorized at his discretion to designate agents for the purpose of collecting income taxes and shall require from them reasonable bond.

2. [If the tax imposed by this article or any part of such tax be not paid at the time when required to be paid under the provisions of this article or in the case of additional taxes, at the time designated by the comptroller, the taxpayer liable to pay such tax shall pay to the comptroller, in addition to the amount of such tax, or part hereof, five per centum of said amount, plus one per centum for each month, or fraction of a month, the tax, or part thereof, remains unpaid.] *The comptroller shall have power, upon making a record of his reasons therefor, to waive or reduce any of the additional taxes or interest provided in section three hundred and seventy-six, subdivisions one and two, and section three hundred and seventy-seven, subdivision three, of this article, or to compromise the same. (Amended by chap. 692, Laws 1920; effective May 10, 1920.)*

§ 380. **Warrant for the collection of taxes.**—If any tax imposed by this article or any portion of such tax be not paid within sixty days after the same becomes due, the comptroller shall issue a warrant under his hand and official seal directed to the sheriff of any county of the State commanding him to levy upon and sell the real and personal property of the person owning the same, found within his county, for the payment of the amount thereof, with the added penalties, interest and the cost of executing the warrant, and to return such warrant to the comptroller and pay to him the money collected by virtue thereof by a time to be therein specified, not less than sixty days from the date of the warrant. The sheriff shall within five days after the receipt of the warrant, file with the clerk of his county a copy thereof, and thereupon the clerk shall enter in the judgment docket, in the column for judgment debtors, the name of the taxpayer mentioned in the warrant, and in appropriate columns the amount of the tax or portion thereof and penalties for which the warrant is issued and the date when such copy is filed, and thereupon the amount of such warrant so docketed shall become a lien upon the title to and interest in real property or chattels real of the person against whom it is issued in the same manner as a judgment duly docketed in the office of such clerk. The said sheriff shall thereupon proceed upon the same in all respects, with like effect, and in the same manner prescribed by law in respect to executions issued against property upon judgments of a court of record, and shall be entitled to the same fees for his services in executing the warrant, to be collected in the same manner. In the discretion of the comptroller a warrant of like terms, force and effect may be issued and directed to any agent authorized to collect income taxes, and in the execution thereof such agent shall have all the powers conferred by law upon sheriffs, but shall be entitled to no fee or compensation in excess of actual expenses paid in the performance of such duty. If a warrant be returned not satisfied in full, the comptroller shall have the same remedies to enforce the claim for taxes against the taxpayer as if the people of the State had recovered judgment against the taxpayer for the amount of the tax.

§ 381. **Action for recovery of taxes.**—Action may be brought at any time by the attorney-general of the State at the instance of the Comptroller in the name of the State to recover the amount of taxes, penalties and interest due under this article.

§ 382. **Distribution of the income tax.**—Of the revenue collected under this article the comptroller shall retain in his hands sufficient to provide at all times a fund in his hands in the sum of two hundred and fifty thousand dollars out of which he shall pay any refunds to which taxpayers shall be entitled under the provisions of this article. Of the remainder, fifty per centum shall be paid into the state treas-

ury to the credit of the general fund. The remaining fifty per centum thereof shall, not later than the first day of July, and in case of moneys subsequently collected at least quarterly thereafter, be distributed and paid to the treasurers of the several counties of the state, in the proportion that the assessed valuation of the real property of each county bears to the aggregate assessed valuation of the real property of the state. As to any county included in the city of New York such payment shall be made to the receiver of taxes in such city and be paid into the general fund for the reduction of taxation of the city of New York. The county treasurer shall apportion the amount so received among the several towns and cities within the county, *except a city containing a part of a town*, in proportion that the assessed valuation of the real property of each town or city bears to the aggregate assessed valuation of the real property of the county[, and shall credit the amount apportioned to each town against the county tax payable by it, and]*The county treasurer shall pay the amount so apportioned to each city to the chief fiscal officer of the city to be paid into the general fund for city purposes; and in a county having a population of over three hundred thousand according to the last federal or state census and adjoining a city of the first class having a population of one million and upwards, the county treasurer shall pay the amount so apportioned to the supervisor of the town and such amount shall be by him credited to general town purposes, and such amounts shall not be apportioned as hereinafter provided. [If the amount to the credit of a town exceeds the county tax from such town, the excess shall be paid] If a town does not contain any part of a city or village, the county treasurer shall pay the amount so apportioned to the town to the supervisor of the town and such amount shall be by him credited to general town purposes. If one or more incorporated villages or cities be wholly or partly within a town, the county treasurer shall divide the amount apportioned to such town between such town and such village, villages or city in the proportions that the assessed valuations of the real property of such town, as appears by the last preceding town assessment-roll and of the real property of such village, villages or city, or the portion thereof wholly within such town, as appears by the last preceding village or city assessment-roll, bear respectively to the aggregate assessed valuation of the real property of such town and of such village, villages or city, determined by adding together the assessed valuation of the real property of the town, as appears by the last preceding town assessment-roll and the assessed valuation of the real property of such village, villages or city, or the portion thereof wholly within such town, as appears by the last preceding village or city assessment-roll, as the case may be. If two or more villages be entitled to share in such division, the county treasurer shall divide between them the amount to which they are entitled in the proportions that the assessed valuation of the real property of such villages located in the town, as appears by the last preceding village assessment-rolls*

bears to the aggregate assessed valuations of the real property of such villages located in such town, as so determined. The county treasurer shall pay over to the chief fiscal officer or officers of such village or villages or such city the amount to which such village, villages or city is entitled in accordance with the above apportionment, and shall pay the remaining portion thereof to the supervisor of the town and such amount shall be by him credited to general town purposes. (Amended by chap. 694, Laws 1920; effective May 10, 1920.)

§ 383. **Comptroller to make regulations and to collect facts.**—The comptroller is hereby authorized to make such rules and regulations, and to require such facts and information to be reported, as it may deem necessary to enforce the provisions of this article.

§ 384. **Secrecy required of official; penalty for violation.**—1. Except in accordance with proper judicial order or as otherwise provided by law, it shall be unlawful for the comptroller, any agent, clerk, or other officer or employee to divulge or make known in any manner the amount of income or any particulars set forth or disclosed in any report or return required under this article. Nothing herein shall be construed to prohibit the publication of statistics so classified as to prevent the identification of particular reports or returns and the items thereof, or the inspection by the attorney-general or other legal representatives of the State of the report or return of any taxpayer who shall bring action to set aside or review the tax based thereon, or against whom an action or proceeding has been instituted in accordance with the provisions of sections three hundred and eighty and three hundred and eighty-one of this chapter. Reports and returns shall be preserved for three years and thereafter until the comptroller orders them to be destroyed.

2. Any offense against subdivision one of this section shall be punished by a fine not exceeding one thousand dollars or by imprisonment not exceeding one year, or both, at the discretion of the court, and if the offender be an officer or employee of the State he shall be dismissed from office and be incapable of holding any public office in this State for a period of five years thereafter.

§ 3. *Notwithstanding the provisions of this section, the comptroller may permit the commissioner of internal revenue of the United States, or the proper officer of any state imposing an income tax upon the incomes of individuals, or the authorized representative of either such officer to inspect the income tax returns of any individuals, or may furnish to such officer or his authorized representative an abstract of the return of income of any individual or supply him with the information concerning any item of income contained in any return, or disclosed by the report of any investigation of the income or return of income of any individual; but such permission shall be granted or such information furnished to such officer or his representative only if the statutes of the United States or of such other*

state, as the case may be, grant substantially similar privileges to the proper officer of this state charged with the administration of the personal income tax law thereof. (Added by chap. 60, Laws 1920; effective March 23, 1920.)

§ 385. **Contract to assume income tax illegal.**—It shall be unlawful for any person to agree or contract directly or indirectly to pay or assume or bear the burden of any tax payable by any taxpayer under the provisions of this article. Any such contract or agreement shall be null and void and shall not be enforced or given effect by any court.

§2. If any clause, sentence, paragraph, or part of this act shall for any reason be adjudged by any court of competent jurisdiction to be invalid, such judgment shall not affect, impair, or invalidate the remainder of this act, but shall be confined in its operation to the clause, sentence, paragraph, or part thereof directly involved in the controversy in which such judgment shall have been rendered.

§ 3. An assessment on account of personal property made prior to August 1st, 1919, shall be as valid and effectual as if this act had not been passed, and nothing in this act shall be construed to impair the obligation to pay taxes assessed on account of personal property in the year 1918 or the year 1919 prior to August 1st whether payable in that year or not.

§ 4. If any city entitled to receive a portion of the taxes collected under article sixteen of the tax law as added by this act the budget for the fiscal year current on July 1st, 1920, shall be completed prior to that date, the board of estimate and apportionment or other board or body having the duty of preparing the budget in such city shall have the power subsequent to such date and before the levy of the taxes on account of the appropriations made by such budget to revise the estimates of city revenue so as to include in such calculation the income to the city from taxes collected under article sixteen of the tax law as added by this act.

APPENDIX D

CORPORATION FRANCHISE TAX LAW

Chapter 726, Laws of New York, 1917, as amended,
Constituting Article 9A of Chapter 62, Laws of
New York, 1909

The amendments are indicated as follows:

1. Matter in *italics* is new.
2. Matter in brackets [] is the original law omitted.

- Section 208. Definitions.
- 209. Franchise tax on corporations based on net income.
 - 210. Corporations exempted from article.
 - 211. Reports of corporations to tax commission.
 - 212. Reports by corporation on basis of fiscal year.
 - 213. Reports to be sworn to; forms.
 - 214. Computation of tax.
 - 214-a. Taxation of corporations acquiring assets or franchises of other corporations.
 - 215. Rate of tax.
 - 216. Penalty for failure to report.
 - 217. Powers of tax commission.
 - 218. Revision and readjustment of accounts by tax commission.
 - 219. Review of determination of tax commission by certiorari and regulations as to writ.
 - 219-a. Audit and statement of tax.
 - 219-b. Notice of tax.
 - 219-c. When tax payable.
 - 219-d. Corrections and changes.
 - 219-e. Warrant for the collection of taxes.
 - 219-f. Action for recovery of taxes; forfeiture of charter by delinquent corporations.
 - 219-g. Deposits of revenues collected.
 - 219-h. Disposition of revenues collected.
 - 219-i. Secrecy required of officials; penalty for violation.
 - 219-j. Exemptions from certain other taxation.
 - 219-k. Limitation of time.
 - 219-l. Personal property defined.

§ 208. **Definitions.**—As used in this article. 1. The term “corporation” includes a joint-stock company or association;

2. The words “tangible personal property” shall be taken to mean corporeal personal property, such as machinery, tools, implements, goods, wares and merchandise, and shall not be taken to mean money, deposits in bank, shares of stock, bonds, notes, credits or evidences of an interest in property and evidences of debt;

3. The term “entire net income” means the total net income before any deductions have been made for taxes paid or to be paid to the Government of the United States on either profits or net income or for any losses sustained by the corporation in other fiscal or calendar years whether deducted by the Government of the United States or not.

§ 209. **Franchise tax on corporations based on net income.**—For the privilege of exercising its franchise in this state in a corporate or organized capacity every domestic corporation, and for the privilege of doing business in this state, every foreign corporation, except corporations specified in the next section, shall annually pay in advance for the year beginning November first next [preceding] *succeeding the first day of July in each and every year* an annual franchise tax, to be computed by the tax commission upon the basis of its entire net income for its fiscal or the calendar year next preceding, as hereinafter provided, which entire net income is presumably the same as the entire net income upon which such corporation is required to pay a tax to the United States [.] *or as otherwise provided by section two hundred and fourteen of the tax law, except that the entire net income of a corporation not organized under the laws of any state within the United States which shall be taken as the basis of computation by the tax commission shall be the entire net income in fact rather than the amount earned in the United States or the amount returned to the United States treasury department.*

§ 210 **Corporations exempted from article.**—Corporations wholly engaged in the purchase and sale of, and holding [of] title to, real estate for themselves, [holding] corporations whose sole business consists of [principal income is derived from] holding the stocks [and bonds] of other corporations for the purpose of controlling the management and affairs of such other corporations, except such as are specifically subject to report under the provisions of subdivision nine of section two hundred and eleven of the tax law, and corporations liable to tax under sections one hundred and eighty-four to one hundred and eighty-nine inclusive of this chapter, banks, savings banks, institutions for savings, title guaranty, insurance or surety corporations shall be exempt from the payment of the taxes prescribed by this article.

§ 211. **Reports of corporations to tax commission.**—Every corporation taxable under this article as well as foreign corporations

having officers, agents or representatives within the state shall annually on or before July first, or within thirty days after the making of its report of entire net income to the United States treasury department for any fiscal or calendar year, *preceding said first day of July*, transmit to the tax commission a report in the form prescribed by the tax commission, specifying: 1. The name and location of the principal place of business of such corporation, the state under the laws of which organized, and the date thereof; the amount of its issued capital stock and the kind of business transacted. Any corporation not organized under the laws of any state within the United States shall state the facts in relation to its entire net income *wherever earned and as though organized under the laws of this state, and instead of stating its income as returned to the United States treasury department.*

2. The amount of its entire net income for its preceding fiscal or the preceding calendar year as shown in the last return of annual net income made by it to the United States treasury department, *except as provided in subdivision one of this section.* If the corporation shall claim that the return made to the United States treasury department was inaccurate, the amount claimed by it to be the net income for such period shall be specified. If any deduction has been allowed for losses sustained by the corporation in prior years the amount so allowed and deducted shall be specified.

3. The average monthly value for the fiscal or calendar year of its real property and tangible personal property in each city, village or portion of a town outside of a village within the state, and the average monthly value of all its real property and tangible personal property wherever located.

4. The average monthly value for the fiscal or calendar year of bills and accounts receivable [for] *arising from* (a) personal property sold by the corporation from merchandise manufactured by it within this state; (b) personal property *owned by the corporation and not manufactured by it within this state but sold by [the corporation] it or its agents* [from merchandise owned by it] and located within the state at the time of the [acceptance] *receipt* of the order [but not manufactured by it within the state]; [and] (c) *the purchase or sale of, or trading in, goods, wares or merchandise not located at any place at which the corporation conducted a permanent or continuous business without the state, and where the bills and accounts receivable arose from orders received or accepted by any officer or agent, or at any place of business, in this state; and (d) services performed* [, based on all orders received at offices maintained by the corporation within this state; excluding bills and accounts receivable arising from sales made from a stock of merchandise or other property located at a place of business maintained by the reporting corporation within the state.] *by any officer, agent or representative of the corporation connected with, sent from, or reporting,*

either directly or indirectly, to any officer located in this state or at any office located, owned, rented or occupied in this state. Also the average total monthly value for the fiscal or calendar year of bills and accounts receivable [for (a) personal property sold by the corporation from merchandise manufactured by it within and without the state, (b) personal property sold by the corporation from merchandise owned by it at the time of acceptance of the order but not manufactured by it; and (c) services performed, based on orders received at offices maintained by the corporation, excluding bills and accounts receivable on orders filled from a stock of merchandise or other property maintained by the reporting company.] arising from the manufacture by it of personal property or the purchase or sale of, or trading in, personal property, or from services performed by the corporation, its officers or agents, excluding those arising in any way from advances or loans.

5. The average total value for the fiscal or calendar year of the stock of other corporations owned by the corporation, and the proportion of the average value of the stock of such other corporations within the state of New York, as allocated pursuant to section two hundred and fourteen of this chapter.

6. If the corporation has no real or tangible personal property within the state, the city, village or portion of a town outside of a village in the state in which is located the office in which its principal financial concerns within the state are transacted.

7. Such other facts as the tax commission may require for the purpose of making [the] any computation required by this article, or for the purpose of comparison with former reports to determine whether or not such reports were erroneous or fraudulent.

8. Any corporation taxable hereunder upon its entire net income may omit from its report the statements required by subdivisions four and five by incorporating in its report a consent to be taxed upon its entire net income. Corporations having no net income shall, however, complete the segregation of assets in every case.

9. *Any corporation owning or controlling, either directly or indirectly, substantially all of the capital stock of another corporation, or of other corporations, liable to report under this article, may be required to make a consolidated report showing the combined entire net income, such assets of the corporations as are required for the purposes of this article, and such other information as the tax commission may require, but excluding intercorporate stockholdings and intercorporate accounts.*

The tax commission may permit the filing of a combined report where substantially all the capital stock of two or more corporations liable to taxation under this article is owned by the same interests. The tax commission may impose the tax provided by this article as though the combined entire net income and segregated assets were those of one cor-

poration, or may, in such other manner as it shall determine, equitably adjust the tax.

Where any corporation liable to taxation under this article conducts the business whether under agreement or otherwise in such manner as either directly or indirectly to benefit the members or stockholders of the corporation, or any of them, or any person or persons, directly or indirectly interested in such business by selling its products or the goods or commodities in which it deals at less than a fair price which might be obtained therefor, or where such a corporation, a substantial portion of whose capital stock is owned either directly or indirectly by another corporation, acquires and disposes of the products of the corporation so owning the substantial portion of its capital stock in such a manner as to create a loss or improper net income, the tax commission may require such facts as it deems necessary for the proper computation provided by this article, and may for the purpose of the act determine the amount which shall be deemed to be the entire net income of the business of such corporation for the calendar or fiscal year, and in determining such entire net income the tax commission shall have regard to the fair profits which, but for any agreement, arrangement or understanding, might be or could have been obtained from dealing in such products, goods or commodities.

§ 212. Reports by corporation on basis of fiscal year.—A corporation which reports to the United States Treasury Department on the basis of its fiscal year, may report to the tax commission upon the same basis, except as provided in Section 214-a of this chapter.

§ 213. Reports to be sworn to ; forms.—Every report required by this article shall have annexed thereto the affidavit of the president, vice-president, secretary or treasurer of the corporation to the effect that the statements contained therein are true. Blank forms of report shall be furnished by the tax commission, on application, but failure to secure such a blank shall not release any corporation from the obligation of making a report herein required. The commission may require a further or supplemental report under this article to contain further information and data necessary for the computation of the tax herein provided.

§ 214. Computation of tax.—If the entire business of the corporation be transacted within the state, the tax imposed by this article, *if imposed upon the entire net income*, shall be based upon the entire net income of such corporation for such fiscal or calendar year as defined in section two hundred and eight of this chapter subject, however, to any correction thereof of fraud, evasion or error, as ascertained by the state tax commission. If the entire business of such corporation be not transacted within the state, the tax imposed by this article shall be based upon a proportion of such entire net income, to be determined in accordance with the following rules: The

proportion of the entire net income of the corporation upon which the tax under this article shall be based, shall be such portion of the entire net income as the aggregate of

1. The average monthly value of the real property and tangible personal property within the state.

2. The average monthly value of bills and accounts receivable [for] arising from (a) personal property sold by the corporation from merchandise manufactured by it within the state; (b) personal property owned by the corporation and not manufactured by it within this state but sold by [the corporation] it or its agents [from merchandise owned by it] and located within the state at the time of the receipt [acceptance] of the order [, but not manufactured by it within the state]; [and] (c) the purchase or sale of, or trading in, goods, wares or merchandise not located at any place at which the corporation conducted a permanent or continuous business without the state, and where the bills and accounts receivable arose from orders received or accepted by any officer or agent, or at any place of business, in this state; and (d) services performed [within this state, excluding bills and accounts receivable arising from sales made from a stock of merchandise or other property located at a place of business maintained by the reporting corporation without this state.] by any officer, agent or representative of the corporation connected with, sent from, or reporting, either directly or indirectly, to any officer located in this state or at any office located, owned, rented or occupied in this state.

3. The proportion of the average value of the stocks of other corporations owned by the corporation, allocated to the state as provided by this section, but not exceeding ten per centum of the real and tangible personal property segregated to this state under this article, bears to the aggregate of

4. The average monthly value of all the real property and tangible personal property of the corporation, wherever located.

5. The average total monthly value for the fiscal or calendar year of bills and accounts receivable [for] arising from (a) personal property sold by the corporation from merchandise manufactured by it within and without this state; and (b) [personal property sold by the corporation from merchandise owned by it at the time of acceptance of the order but not manufactured by it; and (c) services performed both within and without this state, based on orders received at offices maintained by the corporation, excluding bills and accounts receivable or orders filled from a stock of merchandise or other property maintained by the corporation.] the purchase, or sale of, or trading in, personal property, or from services performed by the corporation, its officers or agents, excluding those arising in any way from advances or loans.

6. The average total value of stocks of other corporations owned by the corporation, but not exceeding ten per centum of the aggregate real and tangible personal property set up in this report.

7. *In case any report is made as provided by subdivision nine of section two hundred and eleven of the tax law, the tax commission may assess the tax against either of the corporations whose assets or net income are involved in the report and upon the basis of the combined entire net income and the combined segregated assets of the corporation and upon such other information as it may possess, or may adjust the tax in such other manner as it shall determine to be equitable.*

Real property and tangible personal property shall be taken at its actual value where located. The value of share stock of another corporation owned by a corporation liable hereunder shall for purposes of allocation of assets be apportioned in and out of the state in accordance with the value of the physical property in and out of the state representing such share stock.

It is further provided that every domestic corporation exercising its franchise in this state and every foreign corporation doing business in this state, other than those exempted by section two hundred and ten of this chapter, shall be subject to a minimum tax of not less than ten dollars and not less than one mill upon each dollar of *such a part of its issued capital stock, at its face value, as the amount of its gross assets employed by it in its business in this state bears to its gross assets wherever employed by it in its business.* [the apportionment of the face value of its issued capital stock apportioned to this state, which shall be determined by dividing the amount of the real and tangible personal property in this state by the entire amount of the real and tangible personal property and shown in the report, and multiplying the quotient by the face value of the issued capital stock.] If such a corporation has stock without par value, then the base of the tax shall be [on] such a portion of its [paid in capital as its real and tangible personal property in this state bears to its entire real and tangible personal property.] *issued capital stock as its gross assets employed in its business in this state bear to the entire gross assets employed in its business, and its shares without par value shall be deemed to have a face value of one hundred dollars each for the purposes of this assessment.*

If such a corporation is subject to a tax at the rate of one mill, and it maintains no regular place of business outside this state, except a statutory office, it shall be taxed upon its entire issued capital stock as herein provided.

§ 214-a. Taxation of corporations acquiring assets or franchises of other corporations.—If any corporation taxable under this article shall acquire either directly, indirectly or by merger or consolidation the major portion of the assets or the franchise of another corporation or of corporations exercising any franchise or franchises or doing any business in this state during any year it shall include in its own next annual return, in addition to its own entire net income, so much of the entire net income of the corporation or corporations whose assets or

franchises it acquired as shall not have been used or included in measuring a franchise tax to this State, and shall be taxed upon such combined entire net incomes for the year to ensue and as hereinbefore provided. The provisions for a minimum tax shall be applied only when under such provisions a tax will result in excess of the amount which would be produced by a tax on entire net income as hereinbefore provided and then in lieu thereof.

This section shall be construed as having been in effect as of the date of the original enactment of Article 9-a of the tax law, as added by Chapter 726 of the laws of 1917.

§ 215. **Rate of tax.**—The tax imposed by this article shall be at the rate of four and one-half per centum of the entire net income of the corporation or portion thereof taxable within the state, determined as provided by this article [.] *unless taxable upon its capital stock at the rate of one mill or subject to the minimum tax of ten dollars, as provided in section two hundred and fourteen of the tax law.*

§ 216. **Penalty for failure to report.**—Any corporation which fails to make any report required by this article shall be liable to a penalty of not more than \$5,000 to be paid to the State, to be collected in a civil action, at the instance of the tax commission; and any officer of any such corporation who makes a fraudulent return or statement with intent to defeat or evade the payment of the taxes prescribed by this article shall be liable to a penalty of not more than \$1,000, to be collected in like manner. All moneys recovered as penalties, for a failure to report or for making fraudulent reports shall be paid to the State Comptroller.

§ 217. **Powers of tax commission.**—The tax commission may for good cause shown extend the time within which any corporation is required to report by this article. If any report required by this article be not made as herein required, the tax commission is authorized to make an estimate of the net income of such corporation and of the amount of tax due under this article, from any information in its possession, and to order and state an account according to such estimate for the taxes, penalties and interest due to the state from such corporation. [If the tax imposed upon any corporation under this article is based upon an estimate as provided in this section, the tax commission shall notify such corporation of the time and place at which opportunity will be given to the corporation to be heard in respect thereof. Such notice shall be mailed to the post-office address of the corporation.] All the authority and powers conferred on the tax commission by the provision of section one hundred and ninety-five of the tax law shall have full force and effect in respect of corporations which may be liable hereunder.

§ 218. **Revision and readjustment of accounts by tax commission.**—If an application for revision be filed with the commission by a cor-

poration against which an account is audited and stated within one year from the time any such account shall have been audited and stated, the commission shall grant a hearing thereon and if it shall be made to appear upon any such hearing by evidence submitted to it or otherwise, that any such account included taxes or other charges which could not have been lawfully demanded, or that payment has been illegally made or exacted of any such account, the commission shall resettle the same according to law and the facts, and adjust the accounts for taxes accordingly, *and may, in its discretion, modify the penalty imposed for failure to report as provided in this article, and shall* send notice of its determination thereon to the corporation and state comptroller forthwith.

§ 219. Review of determination of tax commission by certiorari and regulations as to writ.—The determination of the commission upon any application made to it by any corporation for revision and resettlement of any account, as prescribed by this article, may be reviewed in the manner prescribed by and subject to the provisions of Section 199 of this chapter.

No certiorari to review any audit and statement of an account or any determination by the commission under this article shall be granted unless notice of application therefor is made within thirty days after the service of the notice of such determination. Eight days' notice shall be given to the commission of the application for such writ. The full amount of the taxes, percentage, interest and other charges audited and stated in such account must be deposited with the State Comptroller before making the application and an undertaking filed with the commission, in such amount and with such sureties as a justice of the supreme court shall approve, to the effect that if such writ is dismissed or the determination of the commission affirmed, the applicant for the writ will pay all costs and charges which may accrue against it in the prosecution of the writ, including costs of all appeals.

§ 219-a. Audit and statement of tax.—On or before the first day of December in each year the tax commission shall audit and state the account of each corporation known to be liable to a tax under this article, for its preceding fiscal or the preceding calendar year, and shall compute the tax thereon and forthwith notice the same to the State Comptroller for collection. The tax commission shall determine the portion of such tax to be distributed to the several counties and the amounts to be credited to the several cities or towns thereof, when the same is collected, and shall indicate such determination in noticing such tax to the State Comptroller. If the corporation has real property or tangible personal property located in a village, or if it has no real or tangible personal property in the State but the office in which its principal financial concerns within the State are transacted

is located in a village, the tax commission shall indicate such facts to the State Comptroller, with the name of the village in which such office or property is located.

§ 219-b. **Notice of tax.**—Every report required by Section 211 of this chapter shall contain the postoffice address of the corporation and lines or spaces upon which the corporation shall enter its entire net income. Notice of tax assessment shall be sent by mail to the post-office address given in the report, and the record that such notice has been sent shall be presumptive evidence of the giving of the notice and such record shall be preserved by the tax commission.

§ 219-c. **When tax payable.**—The tax hereby imposed shall be paid to the state comptroller on or before the first day of January of each year, or within thirty days after notice of the tax has been given as provided in section two hundred and nineteen-b of this chapter if such notice is given subsequent to the first day of December of the year for which such tax is imposed. If such tax be not so paid, or in the case of additional taxes, if not paid within thirty days after notice of such additional tax has been given as provided in section two hundred and nineteen of this chapter and such notice of additional tax is given subsequent to the first day of December of the year for which such additional tax is imposed, the corporation liable to such tax shall pay to the state comptroller, in addition to the amount of such tax, or additional tax, ten per centum of such amount, plus one per centum for each month the tax or additional tax remains unpaid *but the state comptroller upon submission to him of satisfactory proof that the failure to pay such taxes, or additional taxes, within the time prescribed in this article, was not willful or evasive, may modify the exaction to not less than one per centum for each month following the due date of the tax.* Each such tax or additional tax shall be a lien upon and binding upon the real and personal property of the corporation liable to pay the same from the time when it is payable until the same is paid in full.

§ 219-d. **Corrections and changes.**—If the amount of the net income for any year of any corporation taxable under this article as returned to the United States Treasury Department is changed or corrected by the Commissioner of Internal Revenue or other officer of the United States or other competent authority, such corporation, within ten days after receipt of notice of such change or correction shall make return under oath or affirmation to the tax commission of such changed or corrected net income, and shall concede the accuracy of such determination or state wherein it is erroneous.

The tax commission shall ascertain, from such return and any other information in the possession of the commission, the *entire* net income of such corporation for the fiscal or calendar year for which such change or correction has been made by such commissioner of internal revenue or other officer or authority. All the authority con-

ferred on the tax commission by the provisions of Section 195 of this chapter is hereby granted to it in respect to the ascertainment of such *entire* net income. The tax commission shall thereupon reaudit and restate the account of such corporation for taxes based upon the *entire* net income for such fiscal or calendar year, such reaudit to be according to the *entire* net income so ascertained by the tax commission. The proceedings and determination of the tax commission in the making of such reassessment may be revised and readjusted and reviewed in the manner provided by Sections 218 and 219 of this chapter, as in the case of an original assessment of the tax. If from such reassessment it appears that such corporation shall have paid under this article an excess of tax for the year for which such reassessment is made, the tax commission shall return a statement of the amount of such excess to the Comptroller, who shall credit such corporation with such amount. Such credit may be assigned by the corporation in whose favor it is allowed to a corporation liable to pay taxes under this article, and the assignee of the whole or any part of such credit on filing with the commission such assignment shall thereupon be entitled to credit upon the books of the Comptroller for the amount thereof on the current account for taxes of such assignee in the same way and with the same effect as though the credit had originally been allowed in favor of such assignee. If from such reassessment it appears that an additional tax is due from such corporation for such year, such corporation shall, within thirty days after notice has been given as provided in Section 219-b of this chapter by the tax commission pay such additional tax.

§ 219-e. **Warrant for the collection of taxes.**—If the tax imposed by this article be not paid within thirty days after the same becomes due, unless an appeal or other proceeding shall have been taken to review the same, the Comptroller may issue a warrant under his hand and official seal directed to the sheriff of any county of the State commanding him to levy upon and sell the real and personal property of the corporation owning the same, found within his county, for the payment of the amount thereof, with the added penalties, interest and the cost of executing the warrant, and to return such warrant to the Comptroller and pay to him the money collected by virtue thereof by a time to be therein specified, not less than sixty days from the date of the warrant. Such warrant shall be a lien upon and shall bind the real and personal property of the corporation against whom it is issued from the time an actual levy shall be made by virtue thereof. The sheriff to whom any such warrant shall be directed shall proceed upon the same in all respects, with like effect, and in the same manner as prescribed by law in respect to executions issued against property upon judgments of a court of record, and shall be entitled to the same fees for his services in executing the warrant, to be collected in the same manner.

§ 219-f. Action for recovery of taxes; forfeiture of charter by delinquent corporations.—Action may be brought at any time by the Attorney-General at the instance of the Comptroller, in the name of the State, to recover the amount of any taxes, penalties and interest due under this article. If such taxes be not paid within one year after the same be due, and the Comptroller is satisfied that the failure to pay the same is intentional he shall so report to the Attorney-General, who shall immediately bring an action in the name of the people of the State, for the forfeiture of the charter or franchise of any corporation failing to make such payment, and if it be found that such failure was intentional, judgment shall be rendered in each action for the forfeiture of such charter and for its dissolution if a domestic corporation and if a foreign corporation for the annulment of its franchise to do business in this State.

§ 219-g. Deposit of revenues collected.—The State Comptroller shall deposit all taxes, interest and penalties collected under this article in responsible banks, banking houses or trust companies in the state which shall pay the highest rate of interest to the State for such deposit, to the credit of the State Comptroller on account of the franchise tax. And every such bank, banking house or trust company shall execute and file in his office an undertaking to the State, in the sum, and with such sureties, as are required and approved by the Comptroller, for the safe keeping and prompt payment on legal demand thereof of all such moneys held by or on deposit in such bank, banking house or trust company, with interest thereon on daily balances at such rate as the Comptroller may fix. Every such undertaking shall have indorsed thereon, or annexed thereto, the approval of the Attorney-General as to its form. The State Comptroller shall on the first day of each month make a verified return to the State Treasurer of all revenues received by him under this article during the preceding month, stating by whom and when paid, and shall credit himself with all payments made to county treasurers since his last previous return pursuant to Section 219-h of this chapter.

§ 219-h. Disposition of revenues collected.—The State Comptroller shall on or before the twenty-fifth day of each month pay into the State Treasury to the credit of the general fund all interest and penalties and two-thirds of all taxes received by him under this article during the preceding calendar month, as appears from the return made by him to the State Treasurer. The balance of all taxes collected and received by him under this article from any corporation, as appears from the return made by him to the State Treasurer, shall, on or before the 25th day of April, July, October and January, for the quarter ending with the last day of the preceding month, be distributed and paid by him to the treasurers of the several counties of the State and disposed of by such treasurers, in accordance with the following rules:

1. If the corporation has no tangible personal property within the State, such payment shall be made to the county treasurer, of the county in which is located the office at which its principal financial concerns within the State are transacted;

2. If the corporation has tangible personal property, as shown by its report pursuant to Section 211, in but one city or town of the State, such payment shall be made to the county treasurer of the county in which such city or town is located;

3. If the corporation has tangible personal property in more than one city or town of the State, as shown by its report pursuant to Section 211, such payment shall be made to the county treasurers of the counties in which such cities or towns are located in the proportion that the average monthly value of the tangible personal property of such corporation in the cities and towns of such county bears to the average monthly value of all its tangible personal property within the State;

4. In making such payment to a county treasurer, the State Comptroller shall indicate the portion thereof to be credited to any city or town within the county on account of the location therein of its principal financial office or property as determined by the preceding subdivisions, and if such principal financial office or property is located in a village shall indicate the village in which it is located; if such principal financial office or property is located in a city or in a town outside of a village, the whole of such portion shall be paid to such city or town as hereinafter provided; if such principal financial office or property is located in a village, there shall be paid to such village as hereinafter provided such a part of the entire amount credited to the town as the entire amount of taxes raised by said village, or portion thereof in said town, during the preceding calendar year for village and town purposes bears to the aggregate amount so raised by the town and village during the preceding calendar year for town and village purposes;

5. As to any county wholly included within a city such payment shall be made to the Chamberlain or other chief fiscal officer of such city and be paid into the general fund for city purposes;

6. As to any county not wholly included within a city the county treasurer shall within ten days after the receipt thereof pay to the chief fiscal officer of a city or to the chief fiscal officer of a village or to the supervisor of a town the portion of money received by him from the State Comptroller to which such city, village or town is entitled, which shall be credited by such officer to general city, village or town purposes.

§ 219-i. Secrecy required of officials; penalty for violation.—

1. Except in accordance with proper judicial order or as otherwise provided by law, it shall be unlawful for any tax commissioner, agent, clerk, or other officer or employee to divulge or make known in any manner the amount of income or any particulars set forth or disclosed

in any report under this article. Nothing herein shall be construed to prohibit the publication of statistics so classified as to prevent the identification of particular reports and the items thereof, or the publication of delinquent lists showing the names of taxpayers who have failed to pay their taxes at the time and in the manner provided by Section 219-c together with any relevant information which in the opinion of the Comptroller may assist in the collection of such delinquent taxes; or the inspection by the Attorney General or other legal representatives of the State of the report of any corporation which shall bring action to set aside or review the tax based thereon, or against whom an action or proceeding has been instituted in accordance with the provisions of Sections 216 or 219-f of this article.

Reports shall be preserved for three years, and thereafter until the State Tax Commission orders them to be destroyed;

2. Any offense against the foregoing provision shall be punished by a fine not exceeding \$1,000 or by imprisonment not exceeding one year, or both, at the discretion of the court, and if the offender be an officer or employee of the State he shall be dismissed from office and be incapable of holding any public office in this State for a period of five years thereafter.

§ 219-j. **Exemption from certain other taxation.**—After this article takes effect, corporations taxable thereunder shall not be assessed on any personal property, or on capital stock as provided for in section twelve of this chapter [except for taxes levied for the fiscal year ending December thirty-first, nineteen hundred and seventeen, in taxing districts in which the fiscal year is coterminous with the calendar year; and where taxes are required by law to be levied for local purposes for a fiscal year beginning in nineteen hundred and seventeen and ending in nineteen hundred and eighteen, such corporations shall not be assessed on any personal property or capital stock, as provided for in section twelve of this chapter, except for taxes for such fiscal year. If, in any taxing district, by reason of the provisions of this section as originally enacted by chapter seven hundred and twenty-six of the laws of nineteen hundred and seventeen, the assessment of the personal property or capital stock of any such corporation has been omitted from the assessment-roll for the fiscal year specifically referred to in the first paragraph of this section, the assessors of such district shall enter the same in the assessment-roll first prepared after this act goes into effect, at the valuation of such fiscal year, or if not then valued, at such valuation as the assessors shall determine for such year. Before finally fixing such valuation the assessors shall give to such corporation a notice of at least five days and an opportunity to be heard with reference thereto. Such property shall be taxed at the rate per centum of the fiscal year in which it was omitted from the assessment-roll. The whole amount of tax so imposed on the personal property or capital stock of such corporations shall be deducted from the aggregate of

taxation otherwise to be levied on such taxing district for the current year, before such tax is levied. After this article takes effect corporations taxable thereunder shall not be required to pay the franchise tax imposed by section one hundred and eighty-two of this chapter, or to make the reports called for in sections twenty-seven and one hundred and ninety-two of this chapter, except that, for the purpose, of assessing the personal property or capital stock of such corporations as specifically provided in this section, such corporations may be required to make the report called for in such section twenty-seven. Nothing herein shall be construed to impair the obligation to pay franchise taxes due on or before the fifteenth day of January, nineteen hundred and seventeen, or taxes on personal property or capital stock assessed as specifically provided in this section, whether such taxes have been or may hereafter be assessed. But if any corporation taxed under this article shall have paid or shall hereafter pay taxes on personal property or capital stock assessed as specifically provided in this section, for any part of the calendar year nineteen hundred and eighteen, such corporation shall be entitled to credit, with interest, as hereinafter provided, for the amount of such part of the taxes so paid locally as the portion of the year nineteen hundred and eighteen for which such taxes shall have been paid bears to the entire calendar year. And if, in any taxing district, by reason of the provisions of this section as originally enacted by chapter seven hundred and twenty-six of the laws of nineteen hundred and seventeen, any such corporation¹ shall have paid or shall hereafter pay taxes on personal property or capital stock for the year ending December thirty-first, nineteen hundred and eighteen, such corporation shall be entitled to credit, with interest, as hereinafter provided, for the amount of taxes so paid locally. Such credits shall be granted by the tax commission on the submission of satisfactory proofs that the corporation is entitled thereto. The tax commission shall forthwith notify the corporation and the comptroller of any credit so granted. Such credit may be used by the corporation entitled thereto in the payment of taxes charged against it under this article, or such credit or any part thereof may be assigned by the corporation in whose favor it is allowed to a corporation liable to pay taxes under this article, and the assignee of the whole or any part of such credit on filing with the comptroller such assignment shall thereupon be entitled to credit upon the books of the comptroller for the amount thereof on the account for taxes of such assignee in the same way and with the same effect as though the credit had originally been allowed in favor of such assignee. Upon receipt of notice from the tax commission of any credit under this article the comptroller may refund to the corporation, out of the current revenues in his hands received under this article, the amount of such excess paid by the corporation, without interest, and shall charge the amount or amounts of such excess

against the state treasury and the taxing district or districts in the proportions that such excess was originally credited or paid. In case the amount of current revenues credited to any taxing district under this article is not equal to the charge against any such taxing district on account of such refund, further revenues credited to such taxing district shall first be applied by the comptroller to the liquidation of such charge.]

§ 219-k. **Limitation of time.**—The provisions of the code of civil procedure relative to the limitations of time of enforcing a civil remedy shall not apply to any proceeding or action taken to levy, appraise, assess, determine or enforce the collection of any tax or penalty prescribed by this article.

§ 219-l. **Personal property defined.**—The term “personal property,” for the purposes of the exemption from assessment and taxation thereon locally as granted by Section 219-j of this chapter, shall include any movable machinery and equipment used for trade or manufacture and not essential for the support of the building, structure or superstructure, and removable without material injury thereto. The term “personal property,” as used in such section, shall not include boilers, ventilating apparatus, elevators, plumbing, heating, lighting and power generating apparatus, shafting other than counter-shafting, equipment for the distribution of heat, light, power, gases and liquids, nor any equipment consisting of structures or erections to the operation of which machinery is not essential. An owner of a building is entitled to the same exemption under this section as a lessee.

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COMPARATIVE TABLE OF ARTICLES IN THE COMPTROLLER'S REGULATIONS AND IN REGULATIONS 45

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13	23	78	86	161	151
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21	31	80	88	163	153
22	37	91	1561	164	154
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25	33	95	1564	173	163
26	34	96	1565	174	164
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30	38	100	1569	178	168
31	39	101	1570	179	169
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33	41	112	102	181	171
34	42	113	103	190	201
35	43	114	104	201	251
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37	45	116	106	207	303
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40	47	118	292	209	305
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43	51	120	109, 291	217	1582
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286	1072	523	404	573	1032
287	1075	524	403	574	1036
288	1051	525	405	581	1091
289	1074	526	25	582	1094
290	1080	527	1625		
411	91	528	26		
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COMPARATIVE TABLE OF ARTICLES IN REGULATIONS 45 AND IN COMPTROLLER'S REGULATIONS

(Reprinted from Comptroller's Regulations 1920)

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3	3	85	24	167	177
4	501	86	78	168	178
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22	12	88	80	170	180
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25	526	93	419	251	201
26	528	101	111	271	431
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42	34	122	137	314	504
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44	36	132	142	322	229
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404	523	1021	552	1549	66
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406	530	1032	573	1562	93
407	531	1036	574	1563	94
411	230	1041	556	1564	95
412	231	1051	288	1565	96
421	246	1071	281	1566	97
422	248	1072	286	1567	98
423	249	1074	289	1568	99
424	250	1075	287	1569	100
425	247	1080	290	1570	101
431	529	1091	581	1581	216
441	541	1094	582	1582	217
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